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PREFACE

This publication is a comprehensive, yet simplified study program. It provides a review of all the basic skills and concepts tested on the CPA exam, and teaches important strategies to take the exam faster and more accurately. This tool allows you to take control of the CPA exam.

This simplified and focused approach to studying for the CPA exam can be used:
   As a handy and convenient reference manual
   To solve exam questions
   To reinforce material being studied

Included is all of the information necessary to obtain a passing score on the CPA exam in a concise and easy-to-use format. Due to the wide variety of information covered on the exam, a number of techniques are included:

   Acronyms and mnemonics to help candidates learn and remember a variety of rules and checklists
   Formulas and equations that simplify complex calculations required on the exam
   Simplified outlines of key concepts without the details that encumber or distract from learning the essential elements
   Techniques that can be applied to problem solving or essay writing, such as preparing a multiple-step income statement, determining who will prevail in a legal conflict, or developing an audit program
   Pro forma statements, reports, and schedules that make it easy to prepare these items by simply filling in the blanks
   Proven techniques to help you become a smarter, sharper, and more accurate test taker

This publication may also be useful to university students enrolled in Intermediate, Advanced and Cost Accounting; Auditing, Business Law, and Federal Income Tax classes; Economics, and Finance classes.

Good Luck on the Exam,

Ray Whittington, PhD, CPA
ABOUT THE AUTHOR

Ray Whittington, PhD, CPA, CMA, CIA, is the dean of the College of Commerce at DePaul University. Prior to joining the faculty at DePaul, Professor Whittington was the Director of Accountancy at San Diego State University. From 1989 through 1991, he was the Director of Auditing Research for the American Institute of Certified Public Accountants (AICPA), and he previously was on the audit staff of KPMG. He previously served as a member of the Auditing Standards Board of the AICPA and as a member of the Accounting and Review Services Committee and the Board of Regents of the Institute of Internal Auditors. Professor Whittington has published numerous textbooks, articles, monographs, and continuing education courses.
ABOUT THE CONTRIBUTOR

Natalie T. Churyk, PhD, CPA is the Caterpillar Professor of Accountancy at Northern Illinois University. She teaches in the undergraduate and M.A.S. programs as well as developing and delivering continuing professional education in Northern Illinois University’s CPA and CIA Review programs. Professor Churyk has published in professional and academic journals. She serves on state and national committees relating to education and student initiatives and is a member of several editorial review boards. Professor Churyk is a coauthor on two textbooks: Accounting and Auditing Research: Tools and Strategies and Mastering the Codification and eIFRS: A Case Approach.
OBJECTIVES OF FINANCIAL REPORTING

Financial statements are designed to meet the objectives of financial reporting:
- Balance Sheet
- Direct Information
- Financial Position
- Statement of Earnings and Comprehensive Income
- Direct Information
- Entity Financial Statements
- Performance
- Statement of Cash Flows
- Direct Information
- Entity Cash Flows
- Financial Statements
- Taken As a Whole
- Indirect Information
- Management & Performance
- Qualitative Characteristics of Accounting
- Information

IFRS® and US Conceptual Framework as converged

Fundamental characteristics/Decision usefulness Enhancing characteristics
- Relevance
- Comparability
- Predictive value
- Verifiability
- Feedback
- Value
- Timeliness
- Materiality
- Understandability
- Faithful representation
- Constraints
- Completeness
- Benefit vs. costs
- Neutrality
- Free from error
- Elements of Financial Statements
Assets - Liabilities = Equity

Equity = Contributions by owners - Distributions to owners = Comprehensive Income

Comprehensive Income = Revenues - Expenses + Gains - Losses

Consistency Realization Recognition Allocation Matching Full disclosure Revenue Recognition

Accrual method Collection reasonably assured  Degree of uncollectibility estimable Installment sale Collection not reasonably assured Cost recovery Collection not reasonably assured No basis for determining whether or not collectible Installment Sales Method

Installment receivable balance Cash collections \( \times \) Gross profit percentage \( \times \) Gross profit percentage = Deferred gross profit (balance sheet) = Realized gross profit (income statement) Cost Recovery Method

All collections applied to cost before any profit or interest income is recognized Converting from Cash Basis to Accrual Basis

Revenues

Cash (amount received) xx  Increase in accounts receivable (given)
xx  Decrease in accounts receivable (given) xx  Revenues (plug)
xx  Cost of Sales

Cost of sales (plug) xx  Increase in inventory (given) xx  Decrease in
accounts payable (given) xx Decrease in inventory (given) xx Increase in accounts payable (given) xx Cash (payments for merchandise) xx Expenses

Expense (plug) xx Increase in prepaid expenses (given) xx Decrease in accrued expenses (given) xx Decrease in prepaid expenses (given) xx Increase in accrued expenses (given) xx Cash (amount paid for expense) xx Balance Sheet

| Current Assets | Current Liabilities | Cash | Short-term debt | Trading securities | Accounts payable | Current securities available for sale | Accrued expenses | Accounts receivable | Current income taxes payable | Inventories | Current deferred tax liability | Prepaid expenses | Current portion of long-term debt | Current deferred tax asset | Unearned revenues | Long-Term Investments | Long-Term Debt | Noncurrent securities available for sale | Long-term notes payable | Securities held to maturity | Bonds payable | Investments at cost or equity | Noncurrent deferred tax liability | Property, Plant, & Equipment | Stockholders’ Equity | Intangibles | Preferred stock | Other | Assets | Common stock | Deposits | Additional paid-in capital | Deferred charges | Retained earnings | Noncurrent deferred tax asset | Accumulated other comprehensive income | Current Assets & Liabilities |

| Assets Liabilities | Economic resource | Economic obligation | Future benefit | Future sacrifice | Control of company | Beyond control of company | Past event or transaction | Past event or transaction | Current Assets | Current Liabilities | Converted into cash or used up | Paid or settled | OR | Requires use of current assets | Longer of: | Longer of: | One year | One year | One accounting cycle | One accounting cycle | IFRS and Current Liabilities |

Short-term obligations expected to be refinanced must be classified as current liabilities unless there is an agreement in place prior to the balance sheet date.

A “provision” is a liability that is uncertain in timing or amount. If outcome is probable and measurable, it is not considered a contingency. Probable means greater than 50.

A “contingency is not recognized because it is not probable that an outflow will be required or the amount cannot be measured reliably. Contingencies are disclosed unless
probability is remote

Special Disclosures

Significant Accounting Policies

Inventory method Depreciation method Criteria for classifying investments Method of accounting for long-term construction contracts

Subsequent Events

An event occurring after the balance sheet date but before the financial statements are issued or available to be issued. Measured through the issuance date.

Two types of events are possible:
1. Events that provide additional evidence about conditions existing at the balance sheet date (recognize in the financial statements) 2. Events that provide evidence about conditions that did not exist at the balance sheet date but arise subsequent to that date (disclose in the notes)

IFRS: Subsequent events measured through the date the financial statements are authorized to be issued.

Related-Party Transactions

Exceptions:

Salary Expense reimbursements Ordinary transactions

Reporting the Results of Operations

Preparing an Income Statement

Multiple step Single step Revenues Revenues – Cost of sales + Other income = Gross profit + Gains – Operating expenses = Total revenues Selling expenses – Costs and expenses G & A expenses Cost of sales = Operating income Selling expenses + Other income G & A expenses + Gains Other expenses – Other expenses Losses – Losses Income tax expense = Income before taxes = Income from continuing operations – Income tax expense = Income from continuing operations

Computing Net Income

Income from continuing operations (either approach)
± Discontinued operations ± Extraordinary items = Net income (Cumulative changes section was eliminated by precodification SFAS 154)

IFRS Income Statement

Revenue (referred to as income)
Finance costs (interest expense)
Share of profits and losses of associates and joint ventures accounted for using equity method
Tax expense
Discontinued operations
Profit or loss
Noncontrolling interest in profit and loss
Net profit (loss) attributable to equity holders in the parent
No extraordinary items under IFRS

Errors Affecting Income

Error (ending balance)

Current stmt Prior stmt Asset overstated Overstated No effect Asset understated Understated No effect Liability overstated Understated No effect Liability understated Overstated No effect Error (beginning balance – ending balance is correct)

Asset overstated Understated Overstated Asset understated Overstated Understated Liability overstated Overstated Understated Liability understated Understated Overstated Error (beginning balance – ending balance is not correct)

Asset overstated No effect Overstated Asset understated No effect Understated Liability overstated Understated Liability understated Understated Liability understated No effect Overstated Extraordinary Items

Classification as extraordinary – 2 requirements (both must apply)
Unusual in nature
Infrequent of occurrence
One or neither applies – component of income from continuing operations

Extraordinary

A hail storm damages all of a farmer’s crops in a location where hail storms have never occurred
Acts of nature (usually)

Not Extraordinary

Gains or losses on sales of investments or property, plant, & equipment
Gains or losses due to changes in foreign currency exchange rates
Write-offs of inventory or receivables
Effects of major strikes or changes in value of investments

Change in Accounting Principle: Allowed only if required by new accounting principles or change to preferable method

Use retrospective application of new principle:
1) Calculate revised balance of asset or liability as of beginning of period as if new
principle had always been in use. 2) Compare balance to amount reported under old method. 3) Multiply difference by 100% minus tax rate. 4) Result is treated on books as prior period adjustment to beginning retained earnings. a) Note: Indirect effects (e.g., changes in bonus plans) are reported only in period of change. 5) All previous periods being presented in comparative statements restated to new principle. 6) Beginning balance of earliest presented statement of retained earnings adjusted for all effects going back before that date. 7) IFRS: Similar rules—Voluntary change must provide more reliable and relevant information.  

Journal entry:

\[
\text{Asset or liability } xxx \quad \text{Retained earnings } xxx \quad \text{Current or deferred tax liability (asset) } xxx \quad \text{Or} \quad \text{Retained earnings } xxx \\
\text{Current or deferred tax liability (asset) } xxx \quad \text{Asset or liability } xxx
\]

Special Changes

Changes in accounting principle are handled using the **prospective** method under limited circumstances. No calculation is made of prior period effects and the new principle is simply applied starting at the beginning of the current year when the following changes in principle occur:

Changes in the method of depreciation, amortization, or depletion

Changes whose effect on prior periods is impractical to determine (e.g. changes to LIFO when records don’t allow computation of earlier LIFO cost bases)

(Note: the method of handling changes in accounting principle described here under ASC 250-10 replaces earlier approaches, which applied the **cumulative method** to most changes in accounting principle. Precodification SFAS 154 abolished the use of the cumulative method.)

**Change in Estimate**

No retrospective application

Change applied as of beginning of current period

Applied in current and future periods

**Error Corrections**

Applies to:

Change from unacceptable principle to acceptable principle

Errors in prior period financial statements

When error occurred:

![Diagram](image-url)

**Discontinued Operations**
When components of a business are disposed of, their results are reported in discontinued operations:

Component – An asset group whose activities can be distinguished from the remainder of the entity both operationally and for financial reporting purposes.

Disposal – Either the assets have already been disposed of or they are being held for sale and the entity is actively searching for a buyer and believes a sale is probable at a price that can be reasonably estimated.

All activities related to the component are reported in discontinued operations, including those occurring prior to the commitment to dispose and in prior periods being presented for comparative purposes.

**Reporting Discontinued Operations**

Lower section of the income statement:
- After income from continuing operations
- Before extraordinary items

Reported amount each year includes all activities related to the component from operations as well as gains and losses on disposal, net of income tax effects.

Expected gains and losses from operations in future periods are not reported until the future period in which they occur.

Impairment loss is included in the current period when the fair market value of the component is believed to be lower than carrying amount based on the anticipated sales price of the component in future period.

**Reporting Comprehensive Income**

Statement of Comprehensive Income required as one of financial statements
May be part of Income statement
May be separate statement
Begin with net income
Add or subtract items of other comprehensive income
Other comprehensive income includes:
- Current year’s unrealized gains or losses on securities available for sale
- Current year’s foreign currency translation adjustments
- Current year’s unrealized gains or losses resulting from changes in market values of certain derivatives being used as cash flow hedges

**Accounting for Changing Prices**

**Accounting at Current Cost**

Assets & liabilities reported at current amounts
Income statement items adjusted to current amounts
Inventory reported at replacement cost
Cost of sales = Number of units sold × Average current cost of units during period
Differences in inventory & cost of sales treated as holding gains or losses
Depreciation & amortization – Computed using same method & life based on current cost

**Accounting for Changes in Price Level**

Purchasing power gains & losses relate only to *monetary* items
Monetary assets – money or claim to receive money such as cash & net receivables
Monetary liabilities – obligations to pay specific amounts of money
Company may be monetary creditor or debtor
Monetary creditor – monetary assets > monetary liabilities
Monetary debtor – monetary liabilities > monetary assets
In periods of rising prices
Monetary creditor will experience purchasing power loss
Monetary debtor will experience purchasing power gain

**SEC Reporting Requirements**

Regulation S-X describes form and content to be filed
Regulation S-K describes information requirements
Form S-1 (US)/F-1 (foreign)—registration statement
Form 8-K (US)/6-K (foreign)—material event
Form 10-K (US)/20F (foreign)—annual report
Form 10Q—quarterly report
Schedule 14A—proxy statement
Regulation AB—describes asset-backed securities reporting
Regulation Fair Disclosure (FD)—mandates material information disclosures

**Fair Value Measurements**

Six-step application process
1. Identify asset or liability to measure 2. Determine principle or advantageous market 3. Determine valuation premise 4. Determine valuation technique 5. Obtain inputs (levels) 6. Calculate fair value  Multiple disclosures for assets/liabilities measured at fair value on a recurring/nonrecurring basis

**Fair Value Concepts**

Fair value—the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price) under current market conditions
Principal market (greatest volume of activity)
Most advantageous market (maximizes price received or minimizes amount paid)
Highest and best use—maximize the value of the asset or group of assets
Valuation techniques
Market approach—uses prices and relevant market transaction information Income
approach—converts future amounts to a single current (discounted) amount Cost approach—current replacement cost Fair value hierarchy (level 1, 2, and 3 inputs)  
  Level 1—quoted market prices Level 2—directly or indirectly observable inputs other than quoted market prices Level 3—unobservable inputs  
Fair value option—an election to value certain financial assets and financial liabilities at fair value
Inventories – Module 10

INVENTORIES

Goods In Transit

Abnormal costs expensed in current period instead of being included in inventory:
Idle facility expense
Wasted materials in production
Double freight when items returned and redelivered

Cost of Goods Sold

Beginning inventory
\[ \text{Net purchases} = \text{Cost of goods available for sale} \]
\[ \text{Ending inventory} = \text{Cost of goods sold} \]

Inventory Errors

Periodic Versus Perpetual

Periodic Perpetual Buy merchandise: Purchases Inventory Accounts
payable  Accounts payable Sell merchandise Accounts receivable
Accounts receivable  Sales  Sales  Cost of goods sold  Inventory
Record cost of goods sold  Ending inventory (count)  Cost of goods sold (plug)  Purchases (net amount)  Beginning inventory (balance)
FIFO – Same under either method LIFO – Different amounts for periodic and perpetual
Average – Different amounts for periodic and perpetual
Periodic – Weighted-average

Inventory Valuation Methods

<table>
<thead>
<tr>
<th>Periods of rising prices:</th>
<th>Ending Inventory</th>
<th>Cost of Goods Sold</th>
<th>Gross Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIFO</td>
<td>Highest</td>
<td>Lowest</td>
<td>Highest</td>
</tr>
<tr>
<td>LIFO</td>
<td>Lowest</td>
<td>Highest</td>
<td>Lowest</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Periods of falling prices:</th>
<th>Ending Inventory</th>
<th>Cost of Goods Sold</th>
<th>Gross Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIFO</td>
<td>Lowest</td>
<td>Highest</td>
<td>Lowest</td>
</tr>
<tr>
<td>LIFO</td>
<td>Highest</td>
<td>Lowest</td>
<td>Highest</td>
</tr>
</tbody>
</table>

Applying LIFO

Step 1 – Determine ending quantity
Step 2 – Compare to previous period’s ending quantity
Step 3 – Increases – Add new layer
Step 4 – Small decreases (less than most recent layer) – Reduce most recent layer
Step 5 – Large decreases (more than most recent layer) – Eliminate most recent layer or layers and decrease next most recent layer
Step 6 – Apply appropriate unit price to each layer
For each layer:

Inventory quantity × Price per unit = Inventory value

Application of LIFO

Information given:

<table>
<thead>
<tr>
<th>Ending Quantity</th>
<th>Price per unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>10,000 units $5.00</td>
</tr>
<tr>
<td>Year 2</td>
<td>12,000 units $5.50</td>
</tr>
<tr>
<td>Year 3</td>
<td>15,000 units $6.00</td>
</tr>
<tr>
<td>Year 4</td>
<td>13,500 units $6.50</td>
</tr>
<tr>
<td>Year 5</td>
<td>11,200 units $7.00</td>
</tr>
<tr>
<td>Year 6</td>
<td>13,200 units $7.50</td>
</tr>
</tbody>
</table>

Information applied:

**Year 1:**

<table>
<thead>
<tr>
<th>Layer</th>
<th>Quantity</th>
<th>Price per unit</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base layer</td>
<td>10,000</td>
<td>$5.00</td>
<td>$50,000</td>
</tr>
<tr>
<td>Total</td>
<td>10,000</td>
<td></td>
<td>$50,000</td>
</tr>
</tbody>
</table>

**Year 2:**

<table>
<thead>
<tr>
<th>Layer</th>
<th>Quantity</th>
<th>Price per unit</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 2 layer</td>
<td>2,000</td>
<td>$5.50</td>
<td>$11,000</td>
</tr>
<tr>
<td>Base layer</td>
<td>10,000</td>
<td>$5.00</td>
<td>$50,000</td>
</tr>
<tr>
<td>Total</td>
<td>12,000</td>
<td></td>
<td>$61,000</td>
</tr>
</tbody>
</table>

**Year 3:**
### Dollar-Value LIFO

Less cumbersome than LIFO for inventory consisting of many items
Combines inventory into pools
Increases in some items within a pool offset decreases in others

**Applying Dollar-Value LIFO**

Step 1 – Determine ending inventory at current year’s prices
Step 2 – Divide by current price level index to convert to base year prices
Step 3 – Compare to previous period’s ending inventory at base year prices
Step 4 – Increases – Add new layer at base year prices
Step 5 – Small decreases (less than most recent layer) – Reduce most recent layer
Step 6 – Large decreases (more than most recent layer) – Eliminate most recent layer or layers and decrease next most recent layer
Step 7 – Apply appropriate unit price to each layer

For each layer:

\[
\text{Inventory amount at base year prices} \times \frac{\text{Price}}{\text{Index}} = \text{Inventory amount at base year prices} \times \frac{\text{Price}}{\text{Index}} = \text{Dollar-Value LIFO}
\]

### Application of Dollar-Value LIFO

**Information given:**

*Ending Inventory at Current Prices Price level index Year 1 $200,000 100 Year 2 243,800 106 Year 3 275,000 110 Year 4 255,200 116 Information applied:*

<table>
<thead>
<tr>
<th>Year 3 layer</th>
<th>Year 2 layer</th>
<th>Base layer</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,000 units</td>
<td>2,000 units</td>
<td>10,000 units</td>
</tr>
<tr>
<td>$6.00</td>
<td>$5.50</td>
<td>$5.00</td>
</tr>
<tr>
<td>$18,000</td>
<td>$11,000</td>
<td>$50,000</td>
</tr>
</tbody>
</table>

**Total 15,000 units $79,000**

<table>
<thead>
<tr>
<th>Year 4:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 3 layer</td>
</tr>
<tr>
<td>Year 2 layer</td>
</tr>
<tr>
<td>Base layer</td>
</tr>
</tbody>
</table>

**Total 13,500 units $70,000**

<table>
<thead>
<tr>
<th>Year 5:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 2 layer</td>
</tr>
<tr>
<td>Base layer</td>
</tr>
</tbody>
</table>

**Total 11,200 units $56,800**

<table>
<thead>
<tr>
<th>Year 6:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 3 layer</td>
</tr>
<tr>
<td>Year 2 layer</td>
</tr>
<tr>
<td>Base layer</td>
</tr>
</tbody>
</table>

**Total 13,200 units $71,800**
Year 1

<table>
<thead>
<tr>
<th>Base layer</th>
<th>Base year prices</th>
<th>Index</th>
<th>Dollar-Value LIFO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$200,000</td>
<td>100</td>
<td>$200,000</td>
</tr>
<tr>
<td>Total</td>
<td>$200,000</td>
<td></td>
<td>$200,000</td>
</tr>
</tbody>
</table>

Year 2:

$243,800 ÷ 1.06 = $230,000 (at base year prices)

<table>
<thead>
<tr>
<th>Year 2 layer</th>
<th>Base year prices</th>
<th>Index</th>
<th>Dollar-Value LIFO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$30,000</td>
<td>108</td>
<td>$31,800</td>
</tr>
<tr>
<td>Base layer</td>
<td>$200,000</td>
<td>100</td>
<td>$200,000</td>
</tr>
<tr>
<td>Total</td>
<td>$230,000</td>
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<td>$231,800</td>
</tr>
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</table>

Year 3:

$275,000 ÷ 1.10 = $250,000 (at base year prices)

<table>
<thead>
<tr>
<th>Year 3 layer</th>
<th>Base year prices</th>
<th>Index</th>
<th>Dollar-Value LIFO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$20,000</td>
<td>110</td>
<td>$22,000</td>
</tr>
<tr>
<td>Year 2 layer</td>
<td>$30,000</td>
<td>108</td>
<td>$31,800</td>
</tr>
<tr>
<td>Base layer</td>
<td>$200,000</td>
<td>100</td>
<td>$200,000</td>
</tr>
<tr>
<td>Total</td>
<td>$250,000</td>
<td></td>
<td>$253,800</td>
</tr>
</tbody>
</table>

Year 4:

$255,200 ÷ 1.16 = $220,000 (at base year prices)

<table>
<thead>
<tr>
<th>Year 2 layer</th>
<th>Base year prices</th>
<th>Index</th>
<th>Dollar-Value LIFO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$20,000</td>
<td>106</td>
<td>$21,200</td>
</tr>
<tr>
<td>Base layer</td>
<td>$200,000</td>
<td>100</td>
<td>$200,000</td>
</tr>
<tr>
<td>Total</td>
<td>$220,000</td>
<td></td>
<td>$221,200</td>
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</tbody>
</table>

Dollar-Value LIFO – Calculating a Price Level Index

**Simplified LIFO** – Company uses a published index

**Double Extension Method** – Compare current year to base year

**Cumulative index**

**Link Chain Method** – Annual index

**Lower of Cost or Market**
Gross Profit Method for Estimating Inventory

If gross profit is **percentage of sales:**
\[
\text{Sales} - \text{Cost of sales} = \text{Gross profit}
\]

If gross profit is **percentage of cost:**
\[
\text{Sales} - \text{Cost of sales} = \text{Gross profit} = \text{Cost of goods available} = \text{Ending inventory}
\]

To find cost of sales
\[
\text{Beginning inventory} + \text{Net purchases} - \text{Cost of goods available} = \text{Ending inventory}
\]

Conventional Retail (Lower of Cost or Market)

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
<th>Retail</th>
<th>C/R%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning inventory</td>
<td>XX</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td>+ Net purchases</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ Freight in</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ Net markups</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>= Cost of goods available for sale</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Sales (retail)</td>
<td></td>
<td></td>
<td>O 1</td>
</tr>
<tr>
<td>Net markdowns</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee discounts</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spolage (retail)</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>= Ending inventory at retail</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>\times Cost to retail percentage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>= Ending inventory at approximate lower of cost or market</td>
<td>XX</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

IFRS: Inventory

LIFO Not permissible
Lower of cost or net realizable value (LCNRV) on item-by-item basis
Biological assets carried at fair value less costs to sell at the point of harvest.

**LONG-TERM CONSTRUCTION CONTRACTS**
Percentage of Completion

Use when:
Estimates of costs are reasonably dependable
Estimates of progress toward completion
Reporting profit
Recognized proportionately during contract
Added to construction in process
Balance sheet amount
Current asset – excess of costs and estimated profits over billings
Current liability – excess of billings over costs and estimated profits

**Calculating profit**

Step 1 – Total profit

\[
\text{Contract price (1) } xxx \quad \text{Total estimated cost (2) } xxx \quad \text{Cost incurred to date (1) } xxx
\]

Estimated cost to complete + \( xxx \)

\[
\text{Total estimated profit (3) } = xxx \quad \text{Step 2 – % of completion (Cost to cost method)}
\]

Costs incurred to date (1) \( \div \) Total estimated cost (2) = % of completion (4)

Step 3 – Profit to date \( \times \) % of completion (4) \( \times \) Total estimated profit (3) =

Estimated profit to date (5)

Step 4 – Current period’s profit

Estimated profit to date (5) – Profit previously recognized = Current period’s profit

**Recognizing Losses**

When loss expected:

\[
\text{Estimated loss } xxx + \text{ Profit recognized to date } xxx = \text{ Amount of loss to recognize } xxx \quad \text{Completed Contract}
\]

Income statement amount
Profit recognized in period of completion
Loss recognized in earliest period estimable
Balance sheet amount
Current assets – excess of costs over billings
Current liabilities – excess of billings over costs

**IFRS Construction Contracts**

Prohibits completed contract method
Fixed Assets – Module 11

PROPERTY, PLANT, & EQUIPMENT

General Rule

Capitalized amount = Cost of asset + Costs incurred in preparing it for its intended use
Cost of asset = FMV of asset received or
Cash paid + FMV of assets given

Gifts:

Asset (FMV) xx Income xx Other capitalized costs for assets acquired by gift or purchase:

Shipping Insurance during shipping Installation Testing Land and Building

Total cost:
Purchase price Delinquent taxes assumed Legal fees Title insurance Allocation to land and building – Relative Fair Market Value Method
FMV of land + FMV of building = Total FMV Land = FMV of land ÷ Total FMV x Total Cost
Building = FMV of building ÷ Total FMV x Total Cost

Capitalization of Interest

Capitalize on:
Assets constructed for company’s use Assets manufactured for resale resulting from special order

Do not capitalize on:
Inventory manufactured in the ordinary course of business Interest capitalized:
Interest on debt incurred for construction of asset Interest on other debt that could be avoided by repayment of debt

Computed on:

Weighted-average accumulated expenditures Costs Incurred After Acquisition

Capitalize if:
**Bigger** – the cost makes the asset bigger, such as an addition to a building  
**Better** – the cost makes the asset better, such as an improvement that makes an asset perform more efficiently  
**Longer** – the cost makes the asset last longer, it extends the useful life

Do not capitalize:

*Repairs and maintenance* Depreciation and Depletion

**Basic Terms:**

*Straight-line rate* = \( \frac{100\%}{\text{Useful life (in years)}} \)  
*Book value* = \( \text{Cost} - \text{Accumulated depreciation} \)  
*Depreciable basis* = \( \text{Cost} - \text{Salvage value} \)

**Selection of Method:**

- **Use straight-line** when benefit from asset is uniform over life
- **Use accelerated** when:  
  - Asset more productive in earlier years  
  - Costs of maintenance increase in later years  
  - Risk of obsolescence is high
- **Use units-of-production** when usefulness decreases with use

**Straight-Line Double-Declining Balance**  
Annual depreciation = Annual depreciation \( \times \) Straight-line rate \( \times \) Portion of year \( \times \) Sum-of-the-Years’ Digits

Annual depreciation = Depreciable basis \( \times \) Fraction

Partial year:  
1st year = 1st year’s depreciation \( \times \) portion of year  
2nd year = Remainder of 1st year’s depreciation + 2nd year’s depreciation \( \times \) portion of year  
3rd year = Remainder of 2nd year’s depreciation + 3rd year’s depreciation \( \times \) portion of year

Depreciation rate = Depreciable basis \( \div \) Total estimated units to be produced (hours)

Annual depreciation = Depreciation rate \( \times \) Number of units produced (hours used)

**Group or Composite**

Based on straight-line
Gains or losses not recognized on disposal

\[ \text{Cash (proceeds)} \times \text{Accumulated depreciation (plug)} \times \text{Asset (original cost)} \times \text{Impairment} \]

Occurs if undiscounted future cash flow less than asset carrying amount from events such as:
- A decrease in the market value of the asset
- An adverse action or assessment by a regulator
- An operating or cash flow loss associated with a revenue producing asset

When an impairment loss occurs:
- Asset is written down to fair market value (or discounted net cash flow): Loss due to impairment \( \times \) Accumulated depreciation \( \times \)

Note that test for impairment (future cash flow) is different from write-down amount (net realizable value).

**Application of Impairment Rules**

**Example 1:**

\[ \text{Asset carrying value} - \$1,000,000 \text{ Undiscounted future cash flow expected from asset} - \$900,000 \text{ Fair market value of asset} - \$600,000 \text{ Impairment exists} - \$900,000 \text{ expected cash flow less than } \$1,000,000 \text{ carrying amount Write asset down by } \$400,000 \ ($1,000,000 reduced to } \$600,000) \]

**Example 2:**

\[ \text{Asset carrying value} - \$800,000 \text{ Undiscounted future cash flow expected from asset} - \$900,000 \text{ Fair market value of asset} - \$600,000 \text{ No impairment adjustment} - \$900,000 \text{ expected cash flow exceeds } \$800,000 \text{ carrying amount Disposal of Property, Plant, & Equipment} \]

Cash (proceeds) \( \times \) Accumulated depreciation (balance) \( \times \) Loss on disposal (plug) \( \times \) Gain on disposal (plug) \( \times \) Asset (original cost) \( \times \) A disposal in **involuntary conversion** is recorded in the same manner as a sale.

**IFRS Impairment**

Focuses on events (e.g., breach of contract or significant financial difficulty of the issuer)
- Loss recorded income
- IFRS: Reversal of losses on investments in debt allowed

**Nonmonetary Exchanges**
\[ \text{Cash (amount received)} \times \text{Asset – New (FMV)} \times \text{Accumulated depreciation (balance on old asset)} \times \text{Loss on disposal (plug)} \times \text{Cash (amount paid)} \times \text{Gain on disposal (plug)} \times \text{Asset – Old (Original cost)} \times \text{FMV} \]

Use fair value of asset received or
Fair value of asset given
+ Cash paid
– Cash received

**Exception**

Applies to exchanges when:
- FMV is not determinable
- Exchange is only to facilitate subsequent sales to customers (e.g. ownership of inventory in one city is swapped for similar inventory in another to facilitate prompt delivery to customer in distant city)
- Transaction lacks commercial substance (risk, timing, and amount of future cash flows will not significantly change as a result of the transaction)

**Loss**
- FMV of asset given < Carrying value of asset given

\[ \text{Cash (amount received)} \times \text{Asset – New (FMV)} \times \text{Loss on disposal (plug)} \times \text{Gain – FMV of asset given} \times \text{Carrying value of asset given} \]

Gain recognized only when cash received

\[
\begin{align*}
\text{Cash received} &= \text{Total proceeds (Cash + FMV of asset received)} \\
\text{FMV of asset given} &= \text{Carrying value of asset given} \\
\times \text{Percentage} &= \text{Gain recognized} \\
\text{Cash (amount received)} &= \text{xx} \\
\text{Asset – New (plug)} &= \text{xx} \\
\text{Gain on disposal (computed amount)} &= \text{xx} \\
\text{Asset – Old (carrying value)} &= \text{xx} \\
\end{align*}
\]

No gain recognized when cash paid or no cash involved

\[ \text{Asset – New (plug)} \times \text{Accumulated depreciation (balance on old asset)} \times \text{Cash (amount paid)} \times \text{Asset – Old (original cost)} \times \text{INTANGIBLES} \]

**General Characteristics**

Lack physical substance
Uncertain benefit period
Associated with legal rights

**Initial Accounting**
Capitalize costs of purchasing intangibles
Expense costs of developing intangibles internally
Capitalize costs of preparing for use

*Legal fees* Registration fees Amortization

**Straight-line amortization**

Amortized over **shorter** of:
- Legal life
- Useful life
- Units of sales amortization used if greater than straight-line

Tested for impairment when events suggest undiscounted future cash flow will be less than carrying value of intangible – written down to fair market value.

Intangibles with no clear legal or useful life (trademarks, perpetual franchises) must be examined annually for impairment either qualitatively or quantitatively. If impairment is likely, proceed to impairment test and write down whenever fair market value is less than carrying value.

**Goodwill**

**Acquisition**

Must be part of (an acquisition) business combination

Excess of acquisition price over fair value of underlying net assets

**Internal costs**

May incur development or maintenance costs

All costs are expensed

**Amortization**

No amortization recorded

**Impairment**

Annually, qualitatively (or quantitatively) assess whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If so, perform the two-step impairment test:

1. *Calculate and compare the fair value of the reporting unit to its carrying value.* If carrying value exceeds fair value, proceed to step 2.
2. *Compare the implied fair value of the reporting unit goodwill to the carrying value.* Goodwill written down whenever implied fair value is less than carrying value.

IFRS: Property, Plant, and Equipment
Elect either Cost or Revaluation model (RM). If choose RM Carrying amount = the fair value at date of revaluation less subsequent accumulated depreciation and subsequent accumulated impairment loss Only for assets with value that can be reliably measured Entire class of assets Write asset up or down revaluation surplus account in OCI Can reverse impairment loss Cost method: reversal to income RM: reversal to OCI Requires component depreciation (e.g., parts of an airplane) and review of residual value and useful life each period

**Leasehold Improvements**

Amortize over shorter of:
Useful life
Remaining term of lease

**Patents**

Legal costs of defending a patent
Successful – capitalize legal costs as addition to carrying value of patent
Unsuccessful – recognize legal costs as expense and consider writing down patent

**Research and Development (R & D)**

*Research – aimed at discovery of new knowledge New product or process Improvement to existing product or process Development – converting new knowledge into plan or design R & D assets:*

Used for general R & D activities Capitalize if purchased from others and alternative future uses exist Amortized if capitalized Charge to R & D expense Used for specific project Charge to R & D expense IFRS allows capitalization of development costs if six criteria are met

**Startup Costs**

Costs associated with startup of organization should be immediately expensed

**Franchises**

Initial fee – generally capitalized and amortized
Subsequent payments – generally recognized as expense in period incurred

**Software**
Expense – cost up to technological feasibility  
Capitalize and amortize – costs from technological feasibility to start of production  
Coding and testing  
Production of masters  
Charge to inventory – costs incurred during production  

Amortization of capitalized software costs – larger of:  

**Straight-line**  
Carrying value  
Remaining useful life  
(Current period + future periods)  

**Ratio**  
Current revenues * Carrying value  
Estimated remaining revenues  
(Current revenues + future revenues)  

**Additional amortization:**  
Carrying value (after amortization) > Net realizable value (based on future revenues)  
Excess is additional amortization
Monetary Assets & Liabilities – Module 12

Bank Reconciliation

**Bank balance**
- Deposits in transit
- Outstanding checks
± Errors made by bank
= Corrected balance

**Book balance**
- Amounts collected by bank
+ Unrecorded bank charges
- Errors made when recording transactions
= Corrected balance

**Must be equal**

**Accounts Receivable**

<table>
<thead>
<tr>
<th>Allowance Receivable</th>
<th>Allowance for Uncollectible Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning balance</td>
<td>Allowance for Uncollectible Accounts</td>
</tr>
<tr>
<td>Sales</td>
<td>Collections ( \rightarrow ) Write-offs</td>
</tr>
<tr>
<td>Reinstatements ( \leftarrow )</td>
<td>Write-offs ( \rightarrow ) Reinstatements</td>
</tr>
<tr>
<td>Ending balance</td>
<td>Ending balance</td>
</tr>
</tbody>
</table>

**Net realizable value** = Accounts receivable – Allowance for Uncollectible Accounts

Uncollectible Accounts

<table>
<thead>
<tr>
<th>Income Statement Approach</th>
<th>Balance Sheet Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit sales ( \times ) % uncollectible (given)</td>
<td>Accounts receivable balance ( \times ) % uncollectible</td>
</tr>
<tr>
<td>= Bad debt expense</td>
<td>= Ending balance in allowance</td>
</tr>
</tbody>
</table>

Allowance for Uncollectible Accounts

Allowance Methods - GAAP

- Matching concept – Bad debt expense in period of sale
- Measurement concept – Accounts receivable at net realizable value

Direct Write-off Method – Non-GAAP
Violates matching concept – Bad debt expense when account written off
Violates measurement concept – Accounts receivable overstated at gross amount

Notes Received for Cash

Calculating Payment

Principal amount ÷ Present value factor = Payment amount

Present value factor for annuity based on number of payments and interest rate

Allocating Payments

Payment amount – Interest = Principal reduction

Calculating Interest

\[
\begin{align*}
\text{Beginning balance} & \times \text{Interest rate} \\
\text{Balance after principal reduction} & \times \text{Interest rate}
\end{align*}
\]

\[
= \text{Period up to payment} \\
= \text{Interest up to payment}
\]

Add together for total interest

Notes Received for Goods or Services

Note Balance

Short-term: Amount = Face value
Long-term: Amount = Fair value of goods or services
Present value of payments if fair value not known

Journal entry:

\[
\text{Note receivable - Face amount (given) xxx Revenue - Calculated amount xxx Discount on note receivable (plug) xxx Notes Received for Goods or Services}
\]

Interest Income

\[
\text{Face amount of note – Unamortized discount} = \text{Carrying value of note} \times \text{Interest rate} = \text{Interest income}
\]

Journal entry:

\[
\text{Discount on note receivable xxx Interest income xxx Financing}
\]
Receivables — Discounting

Proceeds from Discounting

\[
\text{Face amount} + \text{Interest income} (\text{Face} \times \text{Interest rate} \times \text{Term}) = \text{Maturity value} - \text{Discount} (\text{Maturity value} \times \text{Discount rate} \times \text{Remaining term}) = \text{Proceeds}
\]

Financing Receivables — Assignment

Treated as loan

\[
\text{Cash—Proceeds (given)} xxx \quad \text{Note payable secured by receivables}
\]

\[
\text{xxx Accounts receivable assigned} xxx \quad \text{Accounts receivable (balance)}
\]

\[
\text{xxx Financing Receivables — Factoring}
\]

Factoring without Recourse

Treated as a sale

\[
\text{Cash (Accounts receivable balance less fee less holdback)} xxx \quad \text{Due from factor (holdback)* xxx \quad \text{Loss on sale (fee charged by the factor)} xxx \quad \text{Accounts receivable (balance)} xxx}
\]

\* Due from factor (receivable) is an amount the factor holds back in case customers return merchandise to the business selling the receivables. If customers return the merchandise, they will not be paying the factor.

Financing with Recourse

Treated as a sale

\[
\text{Cash (Accounts receivable balance less fee less holdback)} xxx \quad \text{Due from factor (holdback) xxx \quad \text{Loss on sale (fee charged by the factor + recourse value)} xxx}
\]

\[
\text{Accounts receivable (balance) xxx \quad Recourse liability* xxx \quad Recourse liability is assigned a fair value and initially increases the loss. If receivables are 100% collected by the factor, the recourse will be reversed:}
\]

\[
\text{Recourse liability xxx \quad Loss on sale xxx Financial Statement Analysis}
\]

Ratios Involving Current Assets & Liabilities
Working capital = current assets – current liabilities  
Current ratio = current assets ÷ current liabilities  
Quick ratio = quick assets ÷ current liabilities  
Quick assets – current assets readily convertible into cash  
Cash  
Accounts receivable  
Investments in trading securities  

**Ratios Involving Receivables**

Accounts receivable turnover = Credit sales ÷ Average accounts receivable  
Days to collect accounts receivable = 365 ÷ Accounts receivable turnover  

or  
Days to collect accounts receivable = Average accounts receivable ÷ Average sales/day  

**Average sales/day = Credit sales ÷ 365**  

**Ratios Involving Inventories**

Inventory turnover = Cost of sales ÷ Average inventory  
Days sales in inventory = 365 ÷ Inventory turnover  

or  
Days sales in inventory = Average inventory ÷ Average inventory sold/day  

**Average inventory sold/day = Cost of sales ÷ 365**  

**Other Ratios**

Operating cycle = Days to collect accounts receivable + Days sales in inventory  
Debt to total assets = Total debt ÷ Total assets  
Debt to equity = Total debt ÷ Total stockholders’ equity  
Return on assets = Net income ÷ Average total assets  

**Accounts Payable**

*Purchase shipment terms Payable already recorded Payable not already recorded Shipping point No adjustment Adjust – add Destination Adjust – deduct No adjustment Contingencies*

**Loss Contingencies**

**Probable** – Accrue & disclose  
Not estimable – Disclose only  
Estimable within range – Accrue minimum of range  

**Reasonably possible** – Disclose only  
Remote – Neither accrued nor disclosed  

**Contingencies and Provisions**

**IFRS**
Distinguishes between contingencies and provisions
Contingencies depend upon some future event and are disclosed only
Provisions are liabilities that are uncertain in timing or amount
Probability threshold is 50%—accrue and disclose
Estimable within a range—accrue the midpoint of the range

**Gain Contingencies**

Never accrue (until realization occurs or is assured beyond reasonable doubt)
May disclose

**Estimated & Accrued Amounts**

Money 1st — Goods or services 2nd
Revenues — unearned
Goods or services 1st — Money 2nd
Revenues — receivable

**Revenue Items**

Calculate amount earned or amount collected

1) **Determine changes in accrual items:** Debit Credit Revenue receivable Increase Decrease Unearned revenue Decrease Increase
2) Prepare journal entry Cash xxx Revenue receivable xxx or xxx
Unearned revenue xxx or xxx Revenues xxx 3) If amount collected is given, that is the debit to cash and the amount required to balance the entry is the amount earned. If the amount earned is given, that is the credit to revenues and the amount required to balance the entry is the amount collected. Expense Items

Calculate amount incurred or amount paid

1) **Determine changes in accrual items:** Debit Credit Prepaid expense Increase Decrease Accrued expense Decrease Increase 2) Prepare journal entry Expense xxx Prepaid expense xxx or xxx Accrued expense xxx or xxx Cash xxx 3) If amount paid is given, that is the credit to cash and the amount required to balance the entry is the amount incurred. If the amount incurred is given, that is the debit to expense and the amount required to balance the entry is the amount paid. Insurance

Prepaid insurance (end of year)
Total premiums paid × Months remaining / Total # of months
Insurance expense
Prepaid insurance (beginning) + Premiums paid – Prepaid insurance (ending)
Royalties

Royalty income for current year
1st payment – includes royalties earned in latter part of previous period early in current period
Include payment
Deduct royalties from previous period
2nd payment – received for royalties earned during current period
Include entire payment
Additional royalties
Add royalties earned for latter part of current period

Service Contract

Service contract revenues – fees received uniformly during period
Fees received × % earned in 1st period × 50% = Deferred service contract revenues

Coupons

Discounts on merchandise Premiums (Prizes) Number of coupons not expired Number of units sold × % expected to be redeemed × % expected to be redeemed ÷ number required per prize – Prizes already sent × Cost per coupon (face + service fee) × Cost per prize – Amount already paid = Liability = Liability

Warranties*

Compensated Absences

Four conditions:
Past services of employees
Amounts vest or accumulate
Probable
Estimable
When all conditions met:
Refinancing Liabilities

To exclude from current liabilities – 2 requirements:
Company intends to refinance on a long-term basis
Company can demonstrate ability to refinance
The ability to refinance can be demonstrated in either of 2 ways:
Refinance on long-term basis after balance sheet date but before issuance
Enter into firm agreement with lender having ability to provide long-term financing

IFRS:
Must have an agreement in place by the balance sheet date to exclude from current liabilities

* When calculating warranty expense, be sure to apply the matching principle (e.g., Expected returns on year 1 sales = 2% in year of sale and 3% the year following the sale. Warranty expense would be calculated using 5%, matching all expenses to the period of the sale).
Leases – Module 13

ACCOUNTING FOR LEASES

Lessee Reporting

Transfer of rights & risks of ownership – At least 1 of 4 criteria

Actual transfer

- Title transfers to lessee by end of term
- Lease contains bargain purchase option

Transfer in substance

- Lease term ≥ 75% of useful life
- Present value of min lease payments ≥ 90% of fair market value

To calculate present value – lessee uses lower of:
  - Incremental borrowing rate
  - Rate implicit in lease (if known)

Capital Leases

Inception of lease

Journal entry to record lease:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leased asset xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Lease obligation xxx</td>
<td>xxx</td>
</tr>
</tbody>
</table>

Amount of asset & liability = PV of minimum lease payments:

- Payments beginning at inception result in annuity due
- Payments beginning at end of first year result in ordinary annuity
- Payments include bargain purchase option or guaranteed residual value (lump sum at end of lease)

Lease payments

Payment at inception:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease obligation xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Cash</td>
<td>xxx</td>
</tr>
</tbody>
</table>

Subsequent payments:
Interest expense xxx  Lease obligation xxx  Cash xxx  Interest amount:
Balance in lease obligation × Interest rate (used to calculate PV) ×
Time since last payment (usually 1 year) = Interest amount

Periodic Expenses - Depreciation

- **Actual transfer** (1 of first 2 criteria)
  - Life = useful life of property
  - Salvage value taken into consideration
- **Transfer in substance** (1 of latter 2 criteria)
  - Life = shorter of useful life or lease term
  - No salvage value

**Periodic Expenses – Executory costs**

- Consist of insurance, maintenance, & taxes
- Recognized as expense when incurred

**Balance Sheet Presentation**

- Leased asset
- Reported as P, P, & E
- Reported net of accumulated depreciation
- Lease obligation
- Current liability = Principal payments due in subsequent period
- Noncurrent liability = Remainder

**Disclosures**

- Amount of assets recorded under capital leases
- Minimum lease payments for each of next 5 years and in aggregate
- Description of leasing activities

**Lessor Reporting**

- Rights & risks of ownership transfer from lessor to lessee?
  - Yes
    - Additional criteria
  - No
    - Operating lease

**Transfer of rights & risks of ownership – At least 1 of 4 criteria**

- Same criteria as lessee
- To calculate present value – lessor uses rate implicit in lease

**Additional Criteria**
Collectibility of lease payments reasonably predictable
No significant uncertainties as to costs to be incurred in connection with lease

Are both additional criteria met?

Yes
Sales-type or direct-financing lease

No
Operating lease

Sales-Type & Direct-Financing Leases

Inception of lease

Journal entry to record lease:
Receivable xxx  Accumulated depreciation (if any) xxx  Asset xxx  Gain (if any) xxx  
Receivable = fair value of property & present value of lease payments
(rate implicit in lease)
Asset & accum dep – To remove carrying value of asset from lessor’s books
Gain
If amount needed to balance the entry, it is a gain or loss and this is a sales-type lease
If the entry balances without a gain or loss, this is a direct financing lease

Collections

At inception of lease:
Cash xxx  Receivable xxx  Subsequent collections:
Cash xxx  Interest income (formula) xxx  Receivable xxx  Interest
amount:
Balance of receivable × Interest rate (implicit in lease) × Time since last
payment (usually 1 year) = Interest amount Balance Sheet Presentation

Receivable
Current asset – Principal collections due within one year
Noncurrent asset – Remainder

Operating Leases

Lessor Accounting

Rent revenue
Various expenses (depreciation on asset, taxes, insurance, & maintenance)

Lessee Accounting
Rent expense
Miscellaneous expenses (taxes, insurance, & maintenance)

**Rent revenue or expense**

Recognized uniformly over lease
Total of rents over term of lease ÷ Number of periods = Rent per period

**Sale-Leaseback Transactions**

**Minor Leaseback**

Leaseback ≤ 10% of fair value of property sold
Sale and leaseback recognized as separate transactions
Gain or loss on sale

**Other Leasebacks**

Seller-lessee retains significant portion of property
Some or all of gain deferred
Deferred amount limited to present value of leaseback payments
Deferred amount spread over lease
Remainder recognized in period of sale

**IFRS Lease Rules**

IFRS: Lease classification by lessee/lessor the same. Key issue: Look at economic
substance to determine if substantially all benefits/risks of ownership transferred
Two types of leases: Finance or operating
IFRS: If sale followed by operating lease, recognize all gain. If sale followed by
financial lease, defer and amortize gain
IFRS: Must bifurcate land and building Four tests any one of which means it is a
finance lease. Note: No 75% or 90% test The lease transfers ownership to the lessee by
the end of the lease term or the lease contains a bargain purchase option, and it is
reasonably certain that the option will be exercised. The lease term is for the major part
of the economic life of the asset The present value of the minimum lease payments at the
inception of the lease is at least equal to substantially all of the fair value of the leased
asset. The leased assets are of a specialized nature such that only the lessee can use them
without modifications.

**BONDS**

**Issuance – Interest date**
**Cash (present value approach)** xxx  Discount or premium (plug) xxx or xxx  
**Bonds payable (face amount)** xxx Issuance – Between interest dates

Cash (sales price approach + interest amount) xxx  Discount or premium (plug) xxx or xxx  
Interest payable (interest amount) xxx  
**Bonds payable (face)** xxx Proceeds

**Present value approach**
- Present value of principal (lump sum) at yield rate + Present value of interest (ordinary annuity) at yield rate

**Sales price approach**
- Sales price given as percentage of face amount
- Multiplied by face to give proceeds amount

**Interest**

Bond issued between interest dates
- Calculated amount

**Face amount of bonds × Stated rate × Portion of year since previous interest date = Interest amount**

**Effective interest method - GAAP**

**Straight-line method – Not GAAP**

**Recording Interest Expense**

*Interest expense xxx*  Bond premium or discount (amortization) xxx or
**Cash or interest payable**

Bond Issue Costs

Recorded as asset
Deferred charge
Amortized (straight-line) over term of bond
Not considered part of carrying value

**Bond Retirement**

Bond payable (face amount) xxx  Bond premium or discount (balance) xxx or xxx  Gain or loss (plug) xxx or xxx  Bond issue costs (balance) xxx  Cash (amount paid) xxx  Gain or loss is extraordinary if retirement is determined to be both unusual and infrequent

**Convertible Bonds**

Recorded as bonds that are not convertible

Upon conversion:

<table>
<thead>
<tr>
<th>Book Value Method</th>
<th>Market Value Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds payable (face) xx</td>
<td>Bonds payable (face) xx</td>
</tr>
<tr>
<td>Prem or disc (bal) xx or xx</td>
<td>Prem or disc (bal) xx or xx</td>
</tr>
<tr>
<td>Com stk (par) xx</td>
<td>Com stk (par) xx</td>
</tr>
<tr>
<td>APIC (diff) xx</td>
<td>APIC (computed) xx</td>
</tr>
<tr>
<td>Gain or loss (diff) xx or xx</td>
<td>Gain or loss (diff) xx or xx</td>
</tr>
</tbody>
</table>

**Book value method**

Issuer price of stock = Carrying value of bonds
No gain or loss

**Market value method**

Issuer price of stock = Fair market value
Gain or loss recognized

**Detachable Warrants**

Allocate proceeds using relative fair value method
Fair value of bonds (without warrants) + Fair value of warrants (without bonds) = Total fair value
Warrants = Proceeds × Value of warrants/total value
Record issuance:
Cash (total proceeds) xx  Discount or premium (plug*) xx or xx  APIC (amount allocated to warrants) xx  Bonds payable (face amount) xx

* Bonds payable – Discount or plus premium = Amount allocated to bonds

**Disclosures**
A bond issuer should disclose:
- The face amount of bonds
- The nature and terms of the bonds including a discussion of credit and market risk, cash requirements, and related accounting policies
- The fair value of the bonds at the balance sheet date, indicated as a reasonable estimate of fair value

**IFRS**

Option to value financial liabilities at fair value

Financial instruments with characteristics of both debt and equity: “Compound instruments.” Convertible bonds and bonds with detachable warrants separated into components of debt and equity. Record liability component at fair value. Plug remaining value assigned to equity component

**TROUBLED DEBT RESTRUCTURING**

**Transfer property to creditor**

Liability (amount forgiven) xxx  Gain or loss on disposal xxx or xxx  Asset (carrying value) xxx  Gain on restructure xxx  Gain (or loss) on disposal = Fair value of asset – Carrying value of asset

Gain on restructure = Carrying value of debt – Fair value of asset

**Issuance of equity**

Liability (amount forgiven) xxx  Common stock (par value) xxx  APIC (based on fair value) xxx  Gain on restructure xxx  APIC = Fair value of stock issued – Par value of stock issued

Gain on restructure = Fair value of stock – Carrying value of debt

**Modification of Terms**

Total payments under new terms:
- If ≥ carrying value of debt – no adjustment made
- If < carrying value of debt – difference is gain

**Treatment of restructuring gain**

Reported in ordinary income unless it is determined that the restructuring is both unusual and infrequent.

**Bankruptcy**
Order of distribution:
1) Fully secured creditors  
   Receive payment in full  
   Excess of fair value of asset over debt added to remaining available money
2) Partially secured creditors  
   Receive payment equal to fair value of collateral  
   Difference considered unsecured debt
3) Unsecured creditors  
   All receive partial payment  
   Remaining available money ÷ Total of unsecured claims = Ratio  
   Ratio multiplied by each claim to determine payment

PENSION PLANS

Pension Expense

Service cost (debit) + Interest (debit – Actual return on plan assets (CPA exam assumes positive returns, so credit) + Unexpected losses (credit)/unexpected gains (debit) ± Amortization of prior service cost (debit) ± Corridor amortization of gains (credit) or losses (debit) in Accumulated Other Comprehensive Income (AOCI) = Pension expense reported in operating income  
   Service cost – Increase in plan’s projected benefit obligation (PBO) resulting from services performed by employees  
   Interest – Beginning PBO × discount (interest) rate  
   Actual return on plan assets – Increase in plan assets after eliminating contributions and adding back distributions  
   Gains or losses – 2 components  
   Difference between actual return and expected return  
   Amortization of AOCI for Gains/Losses in amount when beginning balance > greater of 10% of beginning PBO or 10% of market related value of beginning plan assets  
   Report on Balance Sheet difference between fair value of plan assets and the PBO as a noncurrent asset if overfunded and a noncurrent liability if underfunded in a pension asset/liability account.

Disclosures

Description of funding policies and types of assets held: equity, debt, real estate and other  
Six components of Pension expense for the period  
Expected benefits to be paid each of the next five years and in aggregate for the following five years  
Expected cash contribution for the following year

IFRS Pension Accounting

IFRS: Can choose to recognize all gains or losses in other comprehensive income
(i.e., avoid the corridor approach; corridor approach eliminated for firms with fiscal year ends after January 1, 2013)

IFRS: Do not have to report (un)funded status of postemployment plans on face of balance sheet
IFRS: Requires actual fair value of assets (i.e., no weighted-average)
IFRS: May present different elements of pension expense in different parts of income statement (e.g., interest expense in financing section of income statement and service cost in operating income).

POSTRETIRED BENEFITS

Types of Benefits

Company pays for:
- Health care
- Tuition assistance
- Legal services
- Life insurance
- Day care
- Housing subsidies
- Individuals covered:
  - Retired employees
  - Beneficiaries
  - Covered dependents

Postretirement Benefit Expense

Service cost (debit) + Interest (debit) – Actual return on plan assets (CPA exam assumes positive returns, so credit) + Unexpected losses (credit)/unexpected gains (debit) ± Amortization of prior service cost (debit) ± Corridor amortization of gains (credit) or losses (debit) in Accumulated Other Comprehensive Income (AOCI) = Postretirement benefit expense
Deferred Taxes – Module 14

ACCOUNTING FOR INCOME TAXES (ASC 740/FAS 109)

Income Tax Expense

Taxable income = Pretax accounting income
No temporary differences
Income tax expense = Current income tax expense
No deferred tax effect
Taxable income ≠ Pretax accounting income
Temporary differences
Income tax expense = Current income tax expense ± Deferred income taxes

Current Income Tax

Current income tax expense = Taxable income × Current tax rate
Current tax liability = Current income tax expense – Estimated payments

Taxable income:

Pretax accounting income (financial statement income) ± Permanent differences ± Changes in cumulative amounts of temporary differences =

Taxable income Permanent & Temporary Differences

Permanent differences
Nontaxable income (interest income on municipal bonds) & nondeductible expenses (premiums on officers’ life insurance)
No income tax effect
Temporary differences
Carrying values of assets or liabilities ≠ tax bases
May be taxable temporary differences (TTD) or deductible temporary differences (DTD)

Temporary taxable differences result in deferred tax liabilities and temporary deductible differences result in deferred tax assets

Assets
Financial statement basis > tax basis = TTD Financial statement basis < tax basis = DTD
Liabilities
Financial statement basis > tax basis = DTD Financial statement basis < tax basis = TTD

Often, it is easier to examine the net effect on income. For example, if straight-line depreciation is used for financial statement purposes and MACRS for tax
purposes, depreciation expense for book purposes < that for tax purposes leading to net financial income > net taxable income resulting in a deferred tax liability. Net financial income > net taxable income = deferred tax liability Net financial income < net taxable income = deferred tax asset

Deferred Tax Assets & Liabilities

TTD × Enacted future tax rate = Deferred tax liability
DTD × Enacted future tax rate = Deferred tax asset

Selecting appropriate rate:
1) Determine future period when temporary difference will have tax effect (period of reversal)
2) Determine enacted tax rate for that period

Deferred Tax Asset Valuation Allowance

May apply to any deferred tax asset
Is it more likely than not that some or all of deferred tax asset will not be realized
Consider tax planning strategies
Valuation allowance = portion of deferred tax asset that will not be realized

Deferred Income Tax Expense or Benefit

1) Calculate balances of deferred tax liabilities and assets and valuation allowances
2) Combine into single net amount
3) Compare to combined amount at beginning of period
   Increase in net liability amount = deferred income tax expense
   Decrease in net asset amount = deferred income tax expense
   Increase in net asset amount = deferred income tax benefit
   Decrease in net liability amount = deferred income tax benefit

Balance Sheet Presentation

Identify current and noncurrent deferred tax assets, liabilities, and valuation allowances
   Current – TTD or DTD relates to asset or liability classified as current
   Noncurrent – TTD or DTD relates to asset or liability classified as noncurrent
   TTD or DTD does not relate to specific asset or liability (such as result of net operating loss carryforward) – classify as current or noncurrent depending on period of tax effect

1) Combine current deferred tax assets, liabilities, and valuation allowances into single amount
2) Report as current deferred tax asset or liability
3) Combine noncurrent deferred tax assets, liabilities, and valuation allowances into single amount
4) Report as noncurrent deferred tax asset or liability

IFRS for Deferred Income Taxes

Deferred tax assets/liabilities always noncurrent
Use enacted rate or substantially enacted rate
No valuation allowance (reported net)

**Accounting for Uncertainty in Income Taxes**

Applies to all tax positions related to income taxes subject to ASC 740/FAS 109
Utilizes a two-step approach for evaluating tax positions. Recognition (Step 1) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. Measurement (Step 2) is only addressed if Step 1 has been maintained. Under Step 2, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, that is more likely than not to be realized (i.e., a likelihood of occurrence greater than 50%). Those tax positions failing to qualify for initial recognition under Step 1 are recognized in the first subsequent interim period that they meet the more-likely-than-not standard, and are resolved through negotiation or litigation or on expiration of the statute of limitations. Derecognition of a tax position that was previously recognized occurs when the item fails to meet more-likely-than-not threshold. ASC 740/FIN 48 specifically prohibits the use of a deferred tax valuation allowance as a substitute for derecognition of tax positions.
Stockholders’ Equity – Module 15

STOCKHOLDERS’ EQUITY

Issuance of Common Stock

Stock issued for cash, property, or services:

Journal entry:
Cash, property, or expense (fair value) xxx Common stock (par or stated value) xxx APIC (difference) xxx Common Stock
Subscribed

Subscription – Journal entry:
Cash (down payment) xxx Subscriptions receivable (balance) xxx Common stock subscribed (par or stated value) xxx APIC (difference) xxx Collection and issuance of shares – Journal entries:

Cash (balance) xxx Subscriptions receivable xxx Common stock subscribed (par or stated value) xxx Common stock (par or stated value) xxx Treasury Stock

Acquisition of shares:

<table>
<thead>
<tr>
<th>Cost Method</th>
<th>Par Value Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>TS (cost)</td>
<td>TS (par value)</td>
</tr>
<tr>
<td>Cash</td>
<td>APIC (original amount)</td>
</tr>
<tr>
<td></td>
<td>RE (difference)</td>
</tr>
<tr>
<td></td>
<td>or APIC from TS (difference)</td>
</tr>
<tr>
<td></td>
<td>Cash (cost)</td>
</tr>
</tbody>
</table>

Sale – more than cost:

<table>
<thead>
<tr>
<th>Cost Method</th>
<th>Par Value Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash (proceeds)</td>
<td>Cash (proceeds)</td>
</tr>
<tr>
<td>TS (cost)</td>
<td>TS (par)</td>
</tr>
<tr>
<td>APIC from TS</td>
<td>APIC (difference)</td>
</tr>
</tbody>
</table>

Sale – less than cost:

<table>
<thead>
<tr>
<th>Cost Method</th>
<th>Par Value Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash (proceeds)</td>
<td>Same entry as above</td>
</tr>
<tr>
<td>APIC from TS</td>
<td></td>
</tr>
<tr>
<td>RE (remainder of difference)</td>
<td></td>
</tr>
<tr>
<td>TS (cost)</td>
<td></td>
</tr>
</tbody>
</table>
Characteristics of Preferred Stock

Preference over common stock
Receive dividends prior to common stockholders
**Paid before common on liquidation**
Cumulative preferred stock
Unpaid dividends accumulated as dividends in arrears
Paid in subsequent periods prior to payment of current dividends to common or preferred
Not considered liability until declared
Participating preferred stock
Receive current dividends prior to common stockholders
Receive additional dividends, in proportion to common stockholders, in periods of high dividends

**Equity Instruments with Characteristics of Liabilities**

Financial instruments shares should be classified as liabilities on the balance sheet, even when they appear to be in the form of equity, when any of these characteristics apply:

Preferred shares have a mandatory redemption date payable in cash
An obligation exists to repurchase shares through the transfer of assets to the shareholder.
Shares are convertible to other shares when the exchange rate is based on a fixed monetary value of issuer shares or is tied to variations in the fixed value of something other than the issuer’s shares.
Note that convertible shares whose conversion rate is not adjusted for changes in values do not fall into this category (e.g. preferred stock convertible at a fixed 10 for 1 ratio to the common stock would not be a liability)

**Dividends**

**Cash Dividends**

Recorded when declared
1) Dividends in arrears to preferred stockholders if cumulative 2) Normal current dividend to preferred stockholders 3) Comparable current dividend to common stockholders 4) Remainder  Allocated between common and preferred shares if preferred stock is participating
Paid to common stockholders if preferred stock is nonparticipating

**Property Dividends**

Journal entry
Retained earnings (fmv of property) xxx  Gain (or loss) xxx or xxx  Asset (carrying value of property)  xxx  Liquidating Dividends

Journal entry
Retained earnings (balance) xxx  APIC (plug) xxx  Cash or Dividends payable  xxx  Stock Dividends

Journal entry – Normal stock dividend – usually 20% or less
Retained earnings (fmv of stock issued) xxx  Common stock (par or stated value) xxx  APIC (difference) xxx  Journal entry – Large stock dividend – usually more than 25% – referred to as stock split affected in the form of a stock dividend
Retained earnings (par or stated value) xxx  Common stock (par or stated value) xxx  Preferred Stock – Special Issuances

Preferred with Detachable Warrants

Cash (proceeds) xxx  APIC from warrants (amount allocated) xxx  Preferred stock (par) xxx  APIC from preferred stock (difference) xxx  Amount allocated to warrants using relative fair value method:
Fair value of warrants + Fair value of stock = Total fair value  Allocation:
Fair value of warrants ÷ Total fair value × Proceeds = Amount allocated to warrants
Fair value of stock ÷ Total fair value × Proceeds = Amount allocated to stock

Convertible Preferred Stock

Journal entry – Issuance
Cash (proceeds) xxx  Preferred stock (par) xxx  APIC from preferred stock (difference) xxx  Journal entry – Conversion
Preferred stock (par) xxx  APIC from preferred stock (original amount) xxx  Common stock (par or stated value) xxx  APIC (difference) xxx  Retained Earnings

Appropriations

Set up to disclose to financial statement users future commitments that are not subject to accrual.
Journal entry:
Retained earnings xxx  Retained earnings appropriated for . . . xxx  When the commitment is met, accrued, or avoided, the appropriation is reversed.
Journal entry:
Retained earnings appropriated for . . . xxx  Retained earnings xxx
Prior Period Adjustments

Made to correct errors in financial statements of prior periods
Adjustment to beginning retained earnings
Equal to net amount of errors from periods prior to earliest period presented
Reduced by tax effect
Presented on statement of retained earnings
Unadjusted beginning balance reported
Increased or decreased for prior period adjustment
Result is adjusted beginning balance

Statement of Retained Earnings

\[
\text{Beginning retained earnings, as previously reported } xxx \pm \text{ Prior period adjustments } \underline{xxx} = \text{Beginning retained earnings, as adjusted } xxx + \text{Net income for period } xxx - \text{Dividends } xxx - \text{Appropriations } xxx + \text{Appropriations eliminated } xxx = \text{Ending retained earnings } xxx
\]

Unlike US GAAP, statement of changes in owners’ equity required

Stock Options Plans

Noncompensatory Plans

Noncompensatory when:
All employees participate
Participation uniform among employees
Option period limited to reasonable time
Discount below market price limited to reasonable amount

Compensatory Plans

Journal entry
Deferred compensation xxx APIC – Options xxx Options must be accounted
for using FMV at date of grant based on:
Market price of options with similar characteristics
Option pricing model Binomial distribution model Black-Scholes model
Intrinsic value (stock price – exercise price) only used when FMV cannot be
determined at grant date and must be replaced by FMV as soon as estimate is available
Compensation recognized over service period

IFRS and Stock Options
Applies to all share-based payments
Requires fair-value method in all cases
Measurement of deferred tax asset is based on estimate of future tax deduction at end of each period. Changes in stock prices change to deferred tax asset. Excess tax benefits (windfalls) are recorded first in equity (up to amount of cumulative book compensation expense) and then in equity. Shortfalls become income tax expense. Excess tax benefits are reported as cash inflows from operations. All ESOPs are compensatory.

**Stock Appreciation Rights**

Calculating liability
Stock price – Amount specified in stock appreciation rights = Amount per share × # of stock appreciation rights = Total liability × Portion of service period elapsed = Liability on balance sheet date

Amount needed to increase or decrease liability is recognized as compensation expense.

**Quasi Reorganizations**

Journal entry:
Common stock (reduction in par value) xxx  APIC (plug) xxx or xxx  Retained earnings (eliminate deficit) xxx  Assets (eliminate overstatements) xxx  Book Value Per Share

Calculation:
Total stockholders’ equity – Preferred stock (par value or liquidation preference) – Dividends in arrears on cumulative preferred stock = Stockholders’ equity attributable to common stockholders ÷ Common shares outstanding at balance sheet date = Book value per common share

Disclosure of Information about Capital Structure

Rights & privileges of various debt & equity securities outstanding
Number of shares of common and preferred stock authorized, issued, & outstanding
Dividend & liquidation preferences
Participation rights
Call prices & dates
Conversion or exercise prices or rates & pertinent dates
Sinking fund requirements
Unusual voting rights
Significant terms of contracts to issue additional shares

**Reporting Stockholders’ Equity**
6% cumulative preferred stock, $100 par value, 200,000 shares authorized, 120,000 shares issued and outstanding $ 12,000,000 Common stock, $10 par value, 1,500,000 shares authorized, 1,150,000 shares issued and 1,090,000 shares outstanding 11,500,000 Additional paid-in capital 3,650,000 27,150,000 Retained Earnings:

Unappropriated $ 6,925,000 Retained earnings appropriated for plant expansion 1,400,000 8,325,000 Accumulated other comprehensive income: Accumulated unrealized gain due to increase in value of marketable securities available for sale 750,000 Accumulated translation adjustment (515,000) 235,000 35,710,000 Less:
Treasury stock, 60,000 shares at cost 780,000 Total Stockholders’ Equity $ 34,930,000 Earnings Per Share

Reporting Earnings Per Share

Simple capital structure
No potentially dilutive securities outstanding
Present basic EPS only
Complex capital structure
Potentially dilutive securities outstanding
Dual presentation of EPS – basic EPS & diluted EPS
Potentially dilutive securities – Securities that can be converted into common shares
Convertible bonds and convertible preferred stock
Options, rights, and warrants

Basic EPS

Numerator

Income Available to Common Stockholders

Income from continuing operations – Dividends declared on noncumulative preferred stock – Current dividends on cumulative preferred stock (whether or not declared) = Income from continuing operations available to common stockholders ± Discontinued operations ± Extraordinary items = Net income available to common stockholders

Denominator

Weighted-average common shares outstanding on the balance sheet date

Diluted EPS

Adjust numerator & denominator for dilutive securities
Assume conversion into common shares
Dilutive if EPS decreases

Convertible Preferred Stock
Dilutive if basic EPS is greater than preferred dividend per share of common stock obtainable:
   Add preferred dividends back to numerator
   Add common shares that preferred would be converted into to denominator

**Convertible Bonds**

Dilutive if basic EPS is greater than interest, net of tax, per share of common stock obtainable:
   Add interest, net of tax, to numerator
   Add common shares that bonds would be converted into to denominator

**Options, Rights, & Warrants**

Dilutive when market price exceeds exercise price (proceeds from exercise)
The **treasury stock method** is applied

\[
\text{Number of options} \times \text{Exercise price} = \text{Proceeds from exercise} \\
\text{Average market price of stock during period} \div \text{Proceeds from exercise} = \text{Shares reacquired with proceeds} \\
\text{Shares reacquired with proceeds} - \text{Increase in denominator} = \text{New denominator}
\]

Calculation done on quarter-by-quarter basis

**Presentation of EPS Information**

**Income Statement**

Simple capital structure – Basic EPS only
   Income from continuing operations
   Net income
Complex capital structure – Basic & Diluted EPS
   Income from continuing operations
   Net income

**Additional Disclosures (income statement or notes)**

Discontinued operations
Extraordinary items
METHODS OF REPORTING INVESTMENTS

<table>
<thead>
<tr>
<th>Method</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consolidation</td>
<td>Majority owned (&gt; 50%)</td>
</tr>
<tr>
<td></td>
<td>Equity</td>
</tr>
<tr>
<td></td>
<td>Less than majority owned</td>
</tr>
<tr>
<td></td>
<td>Ability to exercise significant influence</td>
</tr>
<tr>
<td></td>
<td>Ownership generally ≥ 20%</td>
</tr>
<tr>
<td>Cost</td>
<td>Less than majority owned</td>
</tr>
<tr>
<td></td>
<td>Unable to exercise significant influence</td>
</tr>
<tr>
<td></td>
<td>Ownership generally &lt; 20%</td>
</tr>
<tr>
<td></td>
<td>Not an investment in marketable securities</td>
</tr>
<tr>
<td>Special Rules</td>
<td>Less than majority owned</td>
</tr>
<tr>
<td></td>
<td>Unable to exercise significant influence</td>
</tr>
<tr>
<td></td>
<td>Ownership generally &lt; 20%</td>
</tr>
<tr>
<td></td>
<td>Investment in marketable securities</td>
</tr>
</tbody>
</table>

Carrying Value of Investment

\[
\text{Carrying Value of Investment} = \text{Cost + Earnings} - \text{Dividends}
\]

\[
\text{Income reported by investee} \times \% \text{ of ownership} = \text{Unadjusted amount} - \text{Adjustments} = \text{Investor’s share of investee’s earnings}
\]

1) Compare initial investment to FMV of underlying net assets
2) Portion of excess may be due to inventory Deduct from income in the first year (unless inventory not sold during year)
3) Portion of excess may be due to depreciable asset Divide by useful life and deduct from income each year
4) Portion of excess may be due to land No adjustment (unless land sold during year)
5) Remainder of excess attributed to goodwill Test each year for impairment and deduct from income if it has occurred

Application of Equity Method

Information given:

- Investment 25% Cost $400,000
- Book value of investee’s underlying net assets $900,000
- Undervalued assets: Inventory 100,000, Building (20 yrs) 400,000, Land 200,000
- Investee’s unadjusted income $225,000
- Dividends $40,000

Information Applied
Changes to and from the Equity Method

Equity Method to Cost Method
No longer able to exercise significant influence
Usually associated with sale of portion of investment
Apply equity method to date of change
Apply cost method from date of change

Cost Method to Equity Method
Now able to exercise significant influence
Usually associated with additional purchase
Apply equity method retroactively
Affects retained earnings and investment for prior periods

Fair Value Option

An entity may elect to value its securities at fair value.
If elected, available-for-sale, held-to-maturity, or equity method investments
securities MTM and gain/loss goes to income

Marketable Securities (MES)

Transferring MES between Categories

When transferring between categories (e.g., Trading to AFS), the transfer is
1. Accounted for at fair value 2. Unrealized holding gains/losses are
   adjusted so as not to be double counted IFRS Investments
Similar to US GAAP, IFRS classifies securities in categories but the account titles differ.

- Held for Trading (HFT) — further classified as a fair value through profit or loss (FVTPL) security.
  - FVTPL securities are remeasured each accounting period.
- Available for Sale (AFS)
- Held to Maturity (HTM)
- Equity method investments (can use the equity method or FVTPL)
  - Can elect to use the FVTPL method for AFS or HTM securities providing the security has an active market.
  - Once the election is made, it may not be changed.
- Instruments **without** quoted market prices should be accounted for using the cost method.

**Life Insurance**

**Payment of premium:**
- Cash surrender value of life insurance (increase in value) xxx Insurance expense (plug) xxx
- Cash (premium amount) xxx

**Death of insured:**
- Cash (face of policy) xxx Cash surrender value of life insurance (balance) xxx
- Gain (difference) xxx
STATEMENT OF CASH FLOWS

Purpose of Statement

Summarizes sources and uses of cash and **cash equivalents**
Classifies cash flows into operating, investing, and financing activities

**Cash Equivalents**

Easily converted into cash (liquid)
Original maturity ≤ 3 months

Format of Statement

\[
\text{Cash provided or (used) by operating activities} \pm \text{Cash provided or (used) by investing activities} \pm \text{Cash provided or (used) by financing activities} = \text{Net increase or (decrease) in cash & cash equivalents} + \text{Beginning balance} = \text{Ending balance}
\]

Inputs to the Cash Flow Statement

Each item on the balance sheet (change from prior year) and income statement must be accounted for. In general:

**Operating activities:**

Income statement items/adjustments (e.g., sales)
Current assets and current liabilities (e.g., accounts receivable)

**Investing activities:**

Noncurrent assets (e.g., building)

**Financial activities:**

Noncurrent liabilities and equity (e.g., bank loan, stock)
Some changes do not involve cash (equipment purchased with stock) and some do not follow the general rule (e.g., dividends payable is a current liability, but since it is the result of stock ownership, its adjustment will appear in financing activities instead of operating activities).

**Operating Activities**
Components of Direct Method

Collections from customers (plug) xxx  Increase in accounts receivable (given) xxx  Decrease in accounts receivable (given) xxx  Sales (given) xxx  Increase in inventory (given) xxx  Decrease in accounts payable (given) xxx  Cost of sales (given) xxx  Decrease in inventory (given) xxx  Increase in accounts payable (given) xxx  Payments for merchandise (plug) xxx  Adjustments Under Indirect Method

Credit changes are addbacks/debit changes are subtractions, for example Increase in accumulated depreciation added back Increase in accounts payable added back Increase in accounts receivable subtracted Decrease in accounts payable subtracted

Investing Activities

Principal collections on loans receivable + Proceeds from sale of investments (except trading securities) + Proceeds from sale of plant assets – Loans made – Payments to acquire investments (except trading securities) – Payments to acquire plant assets = Cash flows from investing activities

Financing Activities

Proceeds from borrowings + Proceeds from issuing stock – Debt principal payments – Payments to reacquire stock – Payments for dividends = Cash flows from financing activities

Other Disclosures

With direct method:
Reconciliation of net income to cash flows from operating activities (indirect method)
With indirect method:
Payments for interest Payments for income taxes
With all cash flow statements:

*Schedule of noncash investing and financing activities* **IFRS and Cash Flows**

Interest/dividends in either financing or operations sections but must be consistent
BUSINESS COMBINATIONS

Consolidation is required whenever the acquirer has control over another entity. Acquirer is the entity that obtains control of one or more businesses in the business combination.
Ownership of majority of voting stock generally indicates control
Consolidation is required even if control situation is temporary
Consolidation is not appropriate when a majority shareholder doesn’t have effective control: Company is in bankruptcy or reorganization Foreign exchange controls limit power to keep control of subsidiary assets
All consolidations are accounted for as acquisitions The acquirer shall recognize goodwill, the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, and any residual goodwill Recognize separately Acquisition-related costs Assets acquired and liabilities assumed arising from contractual contingencies Bargain purchase (fair value of assets acquired > amount paid) recognized as gain Fair values of research and development assets Changes in the value of acquirer deferred tax benefits

Accounting for an Acquisition

Combination – Records combined

Assets (at fair market values) xxx Separately identifiable assets xx Goodwill (plug) x Liabilities (at fair market values) xxx Stockholders’ equity (2 steps) * xxx OR Cash (amount paid) xxx Combination – Records not combined

Investment (fair value of net assets) xxx Stockholders’ equity (same 2 steps) xxx OR Cash (amount paid) xxx * Credit common stock for par value of shares issued and credit APIC for difference between fair value and par value of shares issued

Earnings

Consolidated net income:
Parent’s net income + Subsidiary’s net income from date of acquisition ± Effects of intercompany transactions – Depreciation on difference between fair value and carrying value of sub’s assets – Impairment
losses on goodwill (if applicable) = Consolidated net income Retained Earnings – Year of Combination

Beginning retained earnings – Parent’s beginning balance + Consolidated net income – Parent’s dividends for entire period = Ending retained earnings CONSOLIDATIONS

Eliminate the Investment

Example 1 – Date of combination – no goodwill or minority interest

Inventory (excess of fair value over carrying value) xxx  Land (excess of fair value over carrying value) xxx  Depreciable assets (excess of fair value over carrying value) xxx  Common stock (sub’s balance) xxx  APIC (sub’s balance) xxx  Retained earnings (sub’s balance) xxx  Investment xxx  Example 2 – Date of combination – no goodwill with minority interest

Inventory (excess of fair value over carrying value) xxx  Land (excess of fair value over carrying value) xxx  Depreciable assets (excess of fair value over carrying value) xxx  Common stock (sub’s balance) xxx  APIC (sub’s balance) xxx  Retained earnings (sub’s balance) xxx  Minority interest (sub’s total stockholders’ equity × minority interest percentage) xxx  Investment xxx  Example 3 – Date of combination – goodwill and minority interest

Inventory (excess of fair value over carrying value) xxx  Land (excess of fair value over carrying value) xxx  Depreciable assets (excess of fair value over carrying value) xxx  Goodwill (plug) xxx  Common stock (sub’s balance) xxx  APIC (sub’s balance) xxx  Retained earnings (sub’s balance) xxx  Minority interest (sub’s total stockholders’ equity × minority interest percentage) xxx  Investment xxx

Calculating goodwill – 4 steps
1) Determine amount paid for acquisition
2) Compare to book value of sub’s underlying net assets
3) Subtract difference between fair values and book values of sub’s assets
4) Remainder is goodwill

Additional entries – after date of acquisition
Debit cost of sales instead of inventory for fair market value adjustment
Recognize depreciation on excess of fair value over carrying value of depreciable assets
Recognize impairment of goodwill (if FMV of goodwill is less than carrying amount)

Eliminating Entries

Intercompany Sales of Inventory
Eliminate gross amount of intercompany sales
Sales xxx  Cost of sales xxx  Eliminate intercompany profit included in ending inventory
Cost of sales xxx  Inventory xxx  Eliminate unpaid portion of intercompany sales
Accounts payable xxx  Accounts receivable xxx  Intercompany
Sales of Property, Plant, & Equipment

Eliminate intercompany gain or loss
Gain on sale (amount recognized) xxx  Depreciable asset xxx  Adjust depreciation
Accumulated depreciation (amount of gain divided by remaining useful life) xxx  Depreciation expense xxx  Intercompany Bond
Holdings

Eliminate intercompany investment in bonds
Bonds payable (face amount of bonds acquired) xxx  Bond premium or discount (amount related to intercompany bonds) xxx or xxx  Gain or loss on retirement (plug) Xxx or xxx  Investment in bonds (carrying value) xxx  Intercompany Bond
Holdings

Also known as special-purpose entities
Control is achieved based on contractual, ownership, or other pecuniary interests
Primary beneficiary — the entity that has controlling financial interest in the VIE and must consolidate it. This must be reassessed every year.
Both conditions must exist for control:
1. Having the power to direct the significant activities of the VIE, and 2. The entity has the obligation to absorb significant losses of the VIE or the right to receive significant benefits. Qualitative approach used to determine control when power is shared among unrelated parties, which could lead to none of the entities consolidating the VIE.
Kick-outs rights — the ability to remove the reporting entity who has the power to direct the VIE’s significant activities
Participating rights — the ability to block the reporting entity with the power to direct the VIE’s significant activities

Push-Down Accounting

The method used to prepare the separate financial statements for significant, very large subsidiaries that are either wholly owned or substantially owned (>90%)
SEC requires (for publicly traded companies) a one-time adjustment under the acquisition method to revalue the subsidiary’s assets and liabilities to fair value.
The entry is made directly on the books to the subsidiary.
Has no effect on the presentation of the consolidated financial statements or separate parent financial statements. The subsidiary’s financial statements would be recorded at fair value rather than historical cost.

**IFRS Business Combinations**

Focus is on the concept of the power to control, with control being the parent’s ability to govern the financial and operating policies of an entity to obtain benefits. Control is presumed to exist if parent owns more than 50% of the votes, and potential voting rights must be considered.

Special-purpose entities IFRS: Consolidated when the substance of the relationship indicates that an entity controls the SPE

Consolidated financial statements required except when parent is a wholly owned subsidiary

Equity method Investments must use equity method (i.e., no fair value option)

Joint ventures can use either equity method or proportionate consolidation method

Push-down accounting not allowed
Derivative Instruments – Module 19

Investments in Derivative Securities

Derivatives – Derive their value from other assets. Examples:
- Stock option – value based on underlying stock price
- Commodity futures contract – value based on underlying commodity price

Initially recorded at cost (or allocated amount) – Reported on balance sheet at fair value

- Trading security – unrealized gains and losses on income statement
- Available for sale security – unrealized gains and losses reported as other comprehensive income in stockholders’ equity

Characteristics of Derivatives

- Settlement in cash or assets easily convertible to cash (such as marketable securities)
- Underlying index on which value of derivative is based (usually the price of some asset)
- No or little net investment at time of creation:
  - Futures-based derivative involves no payments at all when derivative created
  - Such a derivative must be settled on settlement date in all cases
  - Options-based derivative involves small premium payment when derivative created
  - Option holder has right not to settle derivative if results would be unfavorable
  - Payment of premium when derivative created is price of this option

Use of Derivatives

- Speculative – Attempt to profit from favorable change in underlying index
- Gain or loss on change in fair value reported in ordinary income
- Certain derivatives qualify as hedge instruments and must meet the following criteria:
  - Sufficient documentation must be provided at designation
  - The hedge must be highly effective throughout its life It must have the ability to generate changes measured every three months (minimum) It must move in the opposite direction to the offsetting item The cumulative change in value of the hedging instrument should be between 80% and 125% of offsetting item The method assessing effectiveness must be consistent with risk management approach Similar hedges should be assessed similarly
  - If a hedge is not 100% effective, the ineffective portion must be reported in current earnings
  - Fair Value Hedge – Attempt to offset risk of existing asset, liability, or
commitment
    Gain or loss on change in derivative reported in ordinary income Should
approximately offset loss or gain on item being hedged
    Cash Flow Hedge – Attempt to offset risk associated with future expected
transactions
    Gain or loss excluded from ordinary income until offsetting future event affects
income Report as part of other comprehensive income until that time
    Foreign Currency Hedge – Attempt to offset exposure to foreign currencies
    Gain or loss reported in current earnings or other comprehensive income
depending on type of foreign currency hedge (foreign-currency-denominated firm
commitment, available-for-sale security, forecasted transaction, net investment in a
foreign operation)

Financial Instruments

Risk of loss

Market risk – Losses due to fluctuations in market place Credit risk –
Losses due to nonperformance of other party Concentration of credit risk
– Several instruments have common characteristics resulting in similar
risks Required Disclosures

Fair value
    Off-balance-sheet credit risk – credit risk that is not already reflected as an
accrued contingency
    Concentration of credit risk
    Hedging disclosures Objective and strategies Context to understand instrument
Risk management policies A list of hedged instruments

IFRS Derivatives

No requirement for net settlement
    Embedded derivatives: Cannot reassess if “clearly and closely related” unless
change in contract that significantly affects cash flows

Fair Value Option and Measurements

The fair value option

May be applied instrument by instrument, with a few exceptions, such as
investments otherwise accounted for by the equity method
    Is irrevocable
    Is applied only to entire instruments and not to portions of instruments
Available for
Recognized financial assets and financial liabilities with the following major exceptions: An investment in a subsidiary that the entity is required to consolidate Pension and other postretirement benefit plans including employee stock plans Lease assets and liabilities Deposit liabilities, of banks, savings and loan associations, credit unions, etc.
Firm commitments that would otherwise not be recognized at inception and that involve only financial instruments
Nonfinancial insurance contracts and warranties that the insurer can settle by paying a third party to provide those goods or services
Host financial instruments resulting from separation of an embedded nonfinancial derivative instrument from a nonfinancial hybrid instrument
Recognize unrealized gains and losses in earnings for businesses and in statement of activities for nonprofit organizations.

**Fair Value defined**

Exchange price Orderly transaction between market participants to sell the asset or transfer the liability in the principal or most advantageous market for the asset or liability under current market conditions Value is a market-based measurement, not an entity-specific measurement Includes assumptions about Risk inherent in a particular valuation technique or inputs to the valuation technique Effect of a restriction on the sale or use of an asset Nonperformance risk

Expanded disclosures on the inputs used to measure fair value

**Level 1**

Quoted prices in active markets for identical assets or liabilities

**Level 2**

Inputs such as quoted prices on similar assets or liabilities or observable for the asset or liability such as interest rates and yield curves

**Level 3**

Unobservable inputs for the asset or liability that reflect the reporting entity’s own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).
SEGMENT REPORTING

Definition of Segments

Segments identified using management approach:
Component earns revenue and incurs expenses
Separate information is available
Component is evaluated regularly by top management

Reportable Segments – 3 Tests

Revenue test – Segment revenues ≥ 10% of total revenues
Asset test – Segment identifiable assets ≥ 10% of total assets
Profit or loss test
Combine profits for all profitable segments
Combine losses for all losing segments
Select larger amount
Segments profit or loss ≥ 10% of larger amount

Disclosures for Reportable Segments

Segment profit or loss
Segment revenues include intersegment sales
Deduct traceable operating expenses and allocated indirect operating expenses
Do not deduct general corporate expenses
Segment revenues
Segment assets
Interest revenue & expense
Depreciation, depletion, & amortization
Other items

PARTNERSHIP

Admitting a Partner

Calculating the Contribution – No Goodwill or Bonus
Partnership equity (before new partner’s contribution) ÷ 100% – new partner’s
percentage = Total capital after contribution × New partner’s percentage = Amount to be contributed

Journal entry:

\( \text{Cash xxx New partner’s equity xxx Excess Contribution by New Partner – Bonus Method} \)

Partnership equity (before new partner’s contribution) + New partner’s contribution
New partner’s contribution = Total capital after contribution × New partner’s percentage
New partner’s capital – New partner’s capital = Bonus to existing partners

Journal entry:

Cash (new partner’s contribution) xxx Capital, new partner (amount calculated) xxx Capital, existing partners (bonus amount) xxx Bonus is allocated to existing partners using their P & L percentages

\( \text{Excess Contribution by New Partner – Goodwill Method} \)

New partner’s contribution ÷ New partner’s percentage = Total capital after contribution – Total capital of partnership (existing capital + contribution) = Goodwill to existing partners

Journal entry:

Cash (new partner’s contribution) xxx Capital, new partner (new partner’s contribution) xxx Goodwill (amount calculated) xxx Capital, existing partners xxx Goodwill is allocated to existing partners using their P & L percentages

\( \text{Contribution Below New Partner’s Capital – Bonus Method} \)

Partnership equity (before new partner’s contribution) + New partner’s contribution = Total capital after contribution × New partner’s percentage = New partner’s capital – New partner’s contribution = Bonus to new partner

Journal entry:

Cash (new partner’s contribution) xxx Capital, existing partners (bonus amount) xxx Capital, new partner (amount calculated) xxx Bonus is allocated to existing partners using their P & L percentages

\( \text{Contribution Below New Partner’s Capital – Goodwill Method} \)

Partnership equity (before new partner’s contribution) ÷ 100% - new partner’s percentage = Total capital after contribution × New partner’s percentage = New partner’s capital – New partner’s contribution = Goodwill

Journal entry:

\( \text{Cash (new partner’s contribution) xxx Goodwill (amount calculated) xxx Capital, new partner (total) xxx Retiring a Partner} \)

Payment Exceeds Partner’s Balance – Bonus Method
Capital, retiring partner (existing balance) xxx Capital, remaining partners (difference – bonus) xxx Cash (amount paid) xxx Bonus to new partner is allocated to
existing partners using their P & L percentages

**Payment Exceeds Partner’s Balance – Goodwill Method**

Amount paid to retiring partner ÷ Retiring partner’s percentage = Value of partnership on date of retirement – Partnership equity before retirement = Goodwill

Journal entries:
- Goodwill (amount calculated) xxx
- Capital, all partners xxx

Goodwill is allocated according to the partners’ P & L percentages

*Capital, retiring partner xxx*  
*Cash (amount paid to retiring partner) xxx*  

**Partnership Liquidation – 5 steps**

1) Combine each partner’s capital account with loans to or from that partner  
2) Allocate gain or loss on assets sold to partners  
3) Assume remaining assets are total loss – allocate to partners  
4) Eliminate any partner’s negative balance by allocating to remaining partners using their P & L percentages  
5) Resulting balances will be amounts to be distributed to remaining partners

**FOREIGN CURRENCY**

**Foreign Currency Transactions**

- Receivable or payable  
- Record at **spot rate**  
- Adjust to new spot rate on each financial statement date

Journal entry:
- Receivable or payable xxx  
- Foreign currency transaction gain xxx  
- OR
- Foreign currency transaction loss xxx  
- Receivable or payable xxx

Gain or loss = Change in spot rate × Receivable or payable (in foreign currency)

**Forward Exchange Contracts**

- All gains and losses measured using forward rate – rate expected to be in effect when settled
- **Hedge** – Protection against change in exchange rate related to **existing** receivable or payable
- Change in forward rate results in gain or loss on hedge
- This will approximately offset loss or gain on change in spot rate on receivable or
payable
Special hedge contracts:
Hedge of foreign currency investment – gains or losses reported in equity – excluded from net income but included in comprehensive income
Hedge of foreign commitment – gain or loss deferred and offset against transaction
Speculative contracts – Entered into in anticipation of change in rate
Change in forward rate results in gain or loss

Foreign Currency Financial Statements

Conversion to U.S. $:

Functional Currency – Currency of primary economic environment in which entity operates.
1) Functional currency = local currency  Translate from local currency to U.S. $
2) Functional currency = U.S. $  Remeasure from local currency to U.S. $
3) Functional currency neither local currency nor U.S. $  Remeasure from local currency to functional currency
   Translate from functional currency to U.S. $

Remeasurement and Translation

Remeasurement Translation Historical rate: Rate at balance sheet date:* Nonmonetary assets and liabilities  Assets and liabilities  Contributed capital accounts Rate in effect on transaction date  Revenue and expense accounts (or weighted-average rate for period): Current rate: Revenues and expenses  All other items  Gains and losses Difference: Difference: Remeasurement gain or loss  Translation gain or loss  Reported on income statement  Component of stockholders’ equity  Excluded from net income  Included in comprehensive income  
*NOTE: To prepare a translated Statement of Cash Flows, the assets and liabilities must be translated at the weighted-average rate, not the rate at the balance sheet date.

INTERIM FINANCIAL STATEMENTS

General Rules

1) Revenues & expenses recognized in interim period earned or incurred
2) Same principles as applied to annual financial statements Special Rules
Inventory Losses

- Expected to recover within annual period
- Not recognized in interim period
- Offset against recovery in subsequent interim period
- Recognized when clear that recovery will not occur
- Not expected to recover within annual period
- Recognized in interim period
- Recovery in subsequent interim period recognized

Income Taxes

- Estimate of rate that applies to annual period

Other Items

- Property taxes – allocated among interim periods
- Repairs & maintenance
  - Generally recognized in interim period when incurred (including major repairs)
  - Allocated to current & subsequent interim periods when future benefit results
- Disposal of a segment – recognized in interim period in which it occurs
- Extraordinary item – recognized in interim period in which it occurs

IFRS: Interim

Discrete report, therefore use same accounting policies as in year-end financial statements

PERSONAL FINANCIAL STATEMENTS

Basic Statements

- Statement of Financial Condition
- Statement of Changes in Net Worth

Principles Applied

- Assets & liabilities – Reported at fair market values
- Business interests – Reported as single amount
- Real estate
  - When operated as business – reported net of mortgage
  - When not operated as business – asset and mortgage reported separately
Retirement plans
Contributions & earnings on contributions by employee included
Contributions & earnings on contributions by employer included to extent vested
Life insurance – Cash surrender value minus borrowings against policy
Income taxes – 2 components
Income taxes on individual’s income for year to date
Tax effect on difference between tax basis and fair values of assets and liabilities
Other liabilities
Current payoff amount, if available
Otherwise, present value of future payments
GOVERNMENTAL (STATE AND LOCAL) ACCOUNTING

GASB Concept Statements set forth fundamentals on which governmental accounting and reporting standards will be based:

- Objective of governmental accounting & reporting – accountability
- Provide useful information
- Benefit wide range of users

Concepts Statement No. 1 identified three primary users of the external state and local governmental financial reports:

- The citizenry
- Legislative and oversight bodies
- Investors and creditors

Governmental financial information should:
- Demonstrate operations within legal restraints imposed by citizens
- Communicate compliance with laws & regulations related to raising & spending money

- Demonstrate interperiod equity – current period expenditures financed with current revenues

To demonstrate full accountability for all activities, information must include:
- Cost of services
- Sufficiency of revenues for services provided
- Financial position

The concepts statements encourage Service Efforts and Accomplishment (SEA) reporting.

SEA reporting provides more complete information about a governmental entity’s performance than can be provided by traditional financial statements and schedules.

**Funds**

Government comprised of funds – self-balancing sets of accounts – 3 categories:
- Governmental
- Proprietary
- Fiduciary

**Methods of Accounting**

Funds of a governmental unit use two methods of accounting:
- Most funds use **modified accrual accounting**
- Some funds use accrual accounting
Modified Accrual Accounting

Differs from accrual accounting:
Focus of financial reporting is financial position & flow of resources
Revenues are recognized when they become available & measurable
Expenditures are recorded when goods or services are obtained
Expenditures classified by object, function, or character

Financial Statements of Governmental Units

General purpose financial statements – referred to as Comprehensive Annual Financial Report (CAFR) – 5 components
Management discussions & analysis – Presented before financial statements
Government-wide financial statements
Fund financial statements
Notes to financial statements
Required supplementary information – Presented after financial statements and notes

A component unit is a legally separate organization for which the elected officials of a primary government are financially accountable.
Users should be able to distinguish between primary government & component units – component units may be blended when either:
- Governing body of component is essentially the same as that of the primary government
- The component provides services almost exclusively for the primary government
- The component unit’s total debt outstanding, including leases, is expected to be repaid entirely or almost entirely by the primary government

Most component units will be discretely presented

Management Discussion & Analysis (MD&A)

Introduces basic financial statements & provides analytical overview of government’s financial activities
Should include:
- Condensed comparison of current year financial information to prior year
- Analysis of overall financial position and results of operations
- Analysis of balances and transactions in individual funds
- Analysis of significant budget variances
- Description of capital assets and long-term debt activity during the period
- Currently known facts, decisions, or conditions expected to affect financial position or results of operations

Government-Wide Financial Statements

Consist of:
Statement of Net Position
Statement of Activities
Report on overall government
Do not display information about individual funds
Exclude fiduciary activities or component units that are fiduciary
Distinction made between primary government and discretely presented component units
Distinction made between government-type activities and business-type activities of primary government
Government-type activities include governmental funds & internal service funds
Business-type activities include enterprise funds only

Characteristics of Government-Wide Financial Statements

Use economic measurement focus for all assets, liabilities, revenues, expenses, gains, & losses
Apply accrual basis of accounting
Revenues from exchanges or exchange-like transactions recognized in period of exchange
Revenues from nonexchange transactions:
Derived tax revenues imposed on exchange transactions recognized as asset & revenues when exchange occurs
Imposed nonexchange revenues imposed on nongovernment agencies recognized as asset when government has enforceable claim & as revenues when use of resources required or permitted
Government-mandated nonexchange transactions provided by one level of government for another recognized as asset & revenue (or liability & expense) when all eligibility requirements met
Voluntary nonexchange transactions recognized similarly to government-mandated nonexchange transactions

Statement of Net Position

Presents assets, liabilities, deferred outflows of resources, and deferred inflows of resources
Assets & liabilities in order of liquidity
Current & noncurrent portions of liabilities reported
Assets + Deferred Outflows of Resources – Liabilities – Deferred Inflows of Resources = Net Position
3 categories of net position
Net assets invested in capital assets, net of related debt – All capital assets, including restricted assets, net of depreciation & reduced by related debt
Restricted net position – Items with externally imposed restrictions on use distinguishing major categories of restrictions
Unrestricted net position – Remainder

Format of Statement of Net Position
Assets, deferred outflows of resources, liabilities, deferred inflows of resources & net position reported for primary government
Separate columns for government-type activities & business-type activities
Amounts combined in total column
Assets, deferred outflows of resources, liabilities, deferred inflows of resources & net position also reported for component units
Amounts reported similarly as those for primary government
Column is not combined with totals for primary government

**Statement of Activities**

Self-financing activities distinguished from those drawing from general revenues
For each government function
Net expense or revenue
Relative burden
Governmental activities presented by function
Business-type activities presented by business segment
Items reported separately after net expenses of government’s functions:
  General revenues
  Contributions to term & permanent endowments
  Contributions to permanent fund principal
  Special items – those that are unusual or infrequent
  Extraordinary items – those that are unusual and infrequent
  Transfers

**Items on Statement of Activities**

Depreciation – indirect expense charged to function with asset
Allocated among functions for shared assets
Not required to be allocated to functions for general capital assets
Not allocated to functions for eligible general infrastructure assets Government uses an asset management system Government documents assets preserved appropriately
Revenues classified into categories
Amounts received from users or beneficiaries of a program always program revenues
Amounts received from parties outside citizenry are general revenues if unrestricted or program revenues if restricted to specific programs
Amounts received from taxpayers always general revenues
Amounts generated by the government usually general revenues
Contributions to term & permanent endowments, contributions to permanent fund principal, special & extraordinary items, & transfers reported separately

**Format of Statement of Activities**

Information for each program or function reported separately:
Expenses
Charges for services
Operating grants & contributions
Capital grants & contributions
Difference between expenses & revenues reported for each program
Equal to change in net position
Separated into columns for governmental activities and business-type activities
Combined into a total column
Remaining items (general revenues, grants & contributions, special &
extraordinary items, & transfers) reported separately below functions & programs
Divided into governmental activities & business-type activities with total column
Provides change in net position & ending net position with same amounts as
Statement of Net Position
Separate column for component units not combined into total

**Additional Characteristics of Government-Wide Financial Statements**

Internal Amounts
Eliminated to avoid doubling up
Interfund receivables & payables eliminated
Amounts due between government-type & business-type activities presented as
offsetting internal balances
Capital assets include the following:
Land, land improvements, & easements
Buildings & building improvements
Vehicles, machinery, & equipment
Works of art & historical treasures
Infrastructure
All other tangible & intangible assets with initial useful lives > a single period
Only identifiable intangibles Internally generated intangibles begin to be capitalized if
Objective and capacity identified Feasible Intent to complete
Pension plans Single-employer defined benefit plan or agent defined benefit
plan Reports a net pension liability, which is measured as the portion of the actuarial
present value of projected benefit payments attributable to past periods of employee
service minus the pension plan’s fiduciary net position

**Accounting for Capital Assets & Infrastructure**

Capital assets reported at historical cost
Includes capitalized interest & costs of getting asset ready for intended use
Depreciated over useful lives
Inexhaustible assets not depreciated
Infrastructure assets may be depreciated under modified approach
**Infrastructure** includes:
Capital assets with longer lives than most capital assets that are normally
stationary
Roads, bridges, tunnels, drainage systems, water & sewer systems, dams, &
lighting systems
Eligible infrastructure assets not depreciated
Must be part of network or subsystem maintained & preserved at established
condition levels
Additions & improvements increasing capacity or efficiency capitalized
Other expenditures expensed

**Fund Financial Statements**

**Governmental funds** include:
- General fund
- Special revenue funds
- Capital projects funds
- Debt service funds
- Permanent funds

**Proprietary funds** include:
- Enterprise funds
- Internal service funds

**Fiduciary funds** include:
- Pension & other employee benefit trust funds
- Investment trust funds
- Private purpose trust funds
- Agency funds

**Financial Statements of Governmental Funds**

Statements of governmental funds
Balance sheet
Statement of revenues, expenditures, and changes in fund balances
Focus is to report sources, uses, & balances of current financial resources
Apply modified accrual accounting
Capital assets & long-term debt not reported as assets or liabilities
Reports include separate columns for each major governmental fund and single column for total of all nonmajor funds:
- General fund is always major
- Others major if assets, liabilities, revenues, expenditures meet the 5% and 10% tests: Fund at least 5% of “total” column in government-wide financial statements Fund at least 10% of “government-type” column in government-wide financial statements.

**Balance Sheet**

- Reports assets, liabilities, & fund balances
- Reported separately for each major governmental fund
- Fund balances segregated into reserved & unreserved
- Total fund balances reconciled to net position of governmental activities in government-wide financial statements

**Statement of Revenues, Expenditures, & Changes in Fund Balances**

- Reports inflows, outflows, and balances of current financial resources
- Reported separately for each major governmental fund
- Revenues classified by major source
Expenditures classified by function

Format of statement:
Revenues – Expenditures = Excess (deficiency) of revenues over expenditures ± Other financing sources and uses ± Special and extraordinary items = Net change in fund balances + Fund balances – beginning of period = Fund balances – end of period

Change in fund balances reconciled to change in net position of governmental activities in government-wide financial statements

Financial Statements of Proprietary Funds

Statements of proprietary funds
Statement of net position
Statement of Revenues, Expenses, and Changes in Fund Net Position
Statement of Cash Flows
Preparation of statements
Emphasis is measurement of economic resources
Prepared under accrual basis of accounting
Reports include separate column for each enterprise fund meeting 5% and 10% tests: Fund at least 5% of “total” column in government-wide financial statements Fund at least 10% of “business-type” column in government-wide financial statements. Total of nonmajor enterprise funds in a single column Total of all internal service funds in a single column Four categories Operating Noncapital financing Capital financing
Investing Derivatives: Reported at fair value Evaluated for effectiveness each financial reporting period Land held for investment reported at fair value

Statement of Net Position

Prepared in classified format
Current & noncurrent assets & liabilities distinguished
Net position reported in same categories as used in government-wide financial statements

Statement of Revenues, Expenses, & Changes in Fund Net Position

Amounts should be the same as net position & changes in net position shown for business-type activities in government-wide financial statements
Revenues reported by major source
Operating & nonoperating revenues & expenses distinguished
Nonoperating revenues & expenses reported after operating income
Format of statement of revenues, expenses, & changes in fund net position

Operating revenues (listed by source) – Operating expenses (listed by category) = Operating income or loss ± Nonoperating revenues & expenses = Income before other revenues, expenses, gains, losses, & transfers ± Capital contributions, additions to permanent & term endowments, special & extraordinary items, & transfers = Increase or decrease in net position + Net position – beginning of period = Net position – end of period Statement of Cash Flows
Shows sources & uses of cash by major classification
Operating activities reported using direct method
Noncapital financing activities
Capital & related financing activities
Investing activities
Operating income reconciled to cash flows from operating activities (indirect method)

**Financial Statements of Fiduciary Funds**

- Statements of fiduciary funds
- Statement of Net Position
- Statement of Changes in Fiduciary Net Position
- Focus of fiduciary financial statements
- Emphasis on measurement of economic resources
- Prepared using accrual basis of accounting
- Report includes separate column for each major fiduciary fund and column for total of all nonmajor fiduciary funds.
- Selection of major funds based on judgment of entity management
- No 5% and 10% tests since fiduciary funds weren’t included in government-wide financial statements

**Notes to Government Financial Statements**

Intended to provide information needed for fair presentation of financial statements
- Notes will include:
  - Summary of significant accounting policies
  - Disclosure about capital assets & long-term liabilities
  - Disclosure about major classes of capital assets
  - Disclosure about donor-restricted endowments
  - Segment information

**Required Supplementary Information**

Presented in addition to MD & A
- Consists of:
  - Schedule of Funding Progress for all Pension Trust Funds
  - Schedule of Employer Contributions to all Pension Trust Funds
  - Budgetary comparison schedules for governmental funds (reporting basis is same as that chosen by legislative body for budget, and not necessarily that used for financial statements)
  - Information about infrastructure reported under the modified approach
  - Claims development information for any public entity risk pools

**Governmental Funds**
A governmental unit maintains 5 types of governmental funds
- **General fund**: all activities not accounted for in another fund. Only fund that reports positive unassigned fund balance.
- **Special revenue funds**: account for revenues earmarked to finance specific activities.
- **Capital projects funds**: account for construction of fixed assets.
- **Debt service fund**: accumulates resources for payment of general obligation debts of other governmental funds.
- **Permanent funds**: account for resources that are legally restricted.

Fixed assets and LT debt are not reported in governmental funds. Instead, reported in government-wide financial statements.

Four fund balance classifications:
- **Nonspendable**: either in form (e.g., inventory) or legally restricted.
- **Restricted**: either by contributor or law.
- **Committed**: to specific purposes (by highest level of governmental decision-making authority).
- **Assigned**: intend to spend for purpose but not bound to Unassigned (residual of general fund).

**General Fund Accounting**

A governmental unit will have one general fund.
Annual budget is recorded at the beginning of the year.
Revenues, expenditure, & other financing sources & uses are recorded during the year.
Adjustments are made at the balance sheet date.
Budgetary accounts are closed at year-end.

**Beginning of Year**

Governmental unit adopts annual budget for general fund.
Budget recorded with following entry:
- Estimated revenues control xxx
- Estimated other financing sources xxx
- Budgetary fund balance xxx or xxx
- Appropriations xxx
- Estimated other financing uses xxx
- Estimated revenues control = revenues expected to be collected during the year.
- Estimated other financing sources = estimate of proceeds from bond issues & operating transfers in.
- Budgetary fund balance = plug – amount required to balance the entry.
- Appropriations = expenditures expected during the year.
- Estimated other financing uses = expected operating transfers out.

**During the Year**

**Revenue cycle** consists of billing certain revenues, such as property taxes, collecting billed revenues, writing off uncollectible billings, & collecting unbilled revenues.

Billing of revenues:
- Taxes receivable xxx
- Allowance for estimated uncollectible taxes xxx
- Deferred revenues xxx
- Revenues control xxx
- Taxes receivable =
amount billed
   Allowance for estimated uncollectible taxes = billings expected to be uncollectible
   This amount may be adjusted upward or downward during the year
   Offsetting entry will be to revenues control
   Deferred revenues = portion of billed taxes expected to be collected more than 60 days after close of current year
   Revenues control = portion of billed taxes expected to be collected during the current year or within 60 days of close
Collecting billed revenues:
   Cash xxx Taxes receivable xxx Writing off uncollectible amounts:
   Allowance for estimated uncollectible taxes xxx Taxes receivable xxx
Collecting unbilled revenues:
   Cash xxx Revenues control xxx Spending cycle consists of ordering goods & services, receiving the goods & services, and paying for them
Ordering goods & services:
   Encumbrances control (estimated cost) xxx Budgetary fund balance reserved for encumbrances xxx Receiving goods & services:
   Budgetary fund balance reserved for encumbrances (estimated cost) xxx Encumbrances control xxx Expenditures control (actual cost) xxx Vouchers payable xxx Payment:
   Vouchers payable xxx Cash xxx Other financing sources & uses are recorded as the transactions occur:
   Proceeds of long-term debit issues are recorded as other financing sources when received
Operating transfers to or from other funds are reported as other financing uses or sources as the funds are transferred

Adjustments at Balance Sheet Date

Closing entry – eliminating revenues, expenditures, & encumbrances:
   Revenues control xxx Unreserved fund balance (plug) xxx or xxx Expenditures control xxx Encumbrances control xxx The remaining balance in the budgetary fund balance reserved for encumbrances is transferred to a nonbudgetary account:
   Budgetary fund balance reserved for encumbrances xxx Fund balance reserved for encumbrances xxx The governmental unit may decide to recognize inventory as an asset:
   Inventories (increase) xxx Fund balance reserved for inventories xxx or xxx Fund balance reserved for inventories xxx Inventories (decrease) xxx End of Year

Budget recorded in beginning of year is reversed:
   Appropriations xxx Estimated other financing uses xxx Budgetary fund balance xxx or xxx Estimated revenues control xxx Estimated other financing sources xxx Special Revenue Fund
Used to account for revenues that must be used for a particular purpose
Accounting identical to general fund

**Capital Projects Fund**

Used to account for construction of fixed assets
Fund opened when project commences & closed when project complete
Accounting similar to general fund
Differences in accounting for capital projects fund:
1) Budgetary entries generally not made 2) Expenditures generally made under contract
Credit contracts payable
Credit retention payable for deferred payments

**Debt Service Fund**

Used to account for funds accumulated to make principal & interest payments on general obligation debts
Expenditures include principal & interest payable in current period
Resources consist of amounts transferred from other funds (other financing sources) & earnings on investments (revenues)
Amounts used for interest payments separated from amounts used for principal payments

Cash for interest xxx  Cash for principal xxx  Other financing sources  xxx

**Proprietary Funds**

Account for governmental activities conducted similarly to business enterprises
Enterprise fund:
Used to account for business-type activities
Uses accrual basis accounting
Earned income recognized as operating revenues
Shared taxes reported as nonoperating revenues
Internal service fund:
Used to account for services provided to other governmental departments on a fee or cost-reimbursement basis
Resources come from billings to other funds
Reported as operating revenues

**Fiduciary Funds**

**Pension Trust Fund**
Accounts for contributions made by government & employees using accrual accounting
Additional information in notes and supplementary information following notes will include:
  Descriptive information about the plan
  Information about plan investments
  Information about the terms of receivables and nature of reserves
  Components of the pension liability
  Significant assumptions to measure the pension liability
  The measurement date
  A ten-year schedule of changes in pension liability
  A ten-year schedule of the amounts of total pension liability, fiduciary net position, net pension liability, the covered-employee payroll, and selected ratios
  A ten-year schedule of the actuarial computed required contribution, the required contribution, the actual contribution to the plan, and selected ratios
  A ten-year schedule of the annual money-weighted return on pension plan assets

**Investment Trust Fund**

Accounts for assets received from other governments units to be invested on their behalf.
Uses accrual accounting

**Private Purpose Trust Fund**

Accounts for resources held on behalf of private persons or organizations.
Uses accrual accounting

**Agency Fund**

Accounts for money collected for various funds, other governments, or outsiders
Includes only balance sheet accounts
Assets always equal liabilities
Uses modified accrual accounting

**Interfund Transactions**

**Nonreciprocal transfers** are transfers of resources from one fund to another without any receipts of goods or services, such as a transfer of money from the general fund to a capital projects fund.

Paying fund:
Other financing uses control xxx Cash xxx Receiving fund:
Cash xxx Other financing uses control xxx

**Reciprocal transfers** occur when one fund acquires goods or services from another in a transaction similar to one that would occur with outsiders.

Paying fund:
Expenditures control or Expenses xxx Cash xxx Receiving fund:
Cash xxx Revenues control xxx Reimbursements occur when one fund
makes payments on behalf of another fund
    Reimbursing fund:
    Expenditures control or Expenses xxx   Cash xxx   Receiving fund:
    Cash xxx   Expenditures control or Expenses xxx   Loans may be made from
    one fund to another
    Lending fund:
    Due from other fund (fund identified) xxx   Cash xxx   Receiving fund:
    Cash xxx   Due from other fund (fund identified) xxx   Solid Waste
    Landfill Operations

Environmental Protection Agency imposes requirements on solid waste landfills
    Procedures for closures
    Procedures for postclosure care
    Procedures represent long-term obligations accounted for as long-term debt
    Costs to be incurred by governmental funds accounted for in general long-term
debt account group
    Expenditures in governmental funds reduce general long-term debt account group
    balances
    Costs to be incurred by proprietary funds accounted for directly in funds
    Costs associated with closure and postclosure procedures accounted for during
    periods of operation
ACCOUNTING FOR NONPROFIT ENTITIES

Financial Statements of Not-for-Profit Organizations

All not-for-profit organizations must prepare at least 3 financial statements
Not-for-profit organizations include:
Hospitals
Colleges & universities
Voluntary health & welfare organizations (VHW)
Required financial statements for all types include:
Statement of Financial Position
Statement of Activities
Statement of Cash Flows
VHWs must also prepare a Statement of Functional Expenses

**Statement of Financial Position**

Includes assets, liabilities, & net assets
Unrestricted net assets – available for general use, including those set aside by board of trustees
Temporarily restricted net assets – donated by outside party & restricted to specific purpose
Permanently restricted net assets – donated by outside party & required to be invested with earnings restricted or unrestricted

**NOT-FOR-PROFIT COMPANY STATEMENT OF FINANCIAL POSITION DECEMBER 31, 20X2**

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Liabilities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>Marketable securities</td>
<td>Notes payable</td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>Bonds payable</td>
</tr>
<tr>
<td>Inventory</td>
<td>Total liabilities</td>
</tr>
<tr>
<td>P, P, &amp; E</td>
<td>Unrestricted</td>
</tr>
<tr>
<td>Total assets</td>
<td>Temporarily restricted</td>
</tr>
<tr>
<td></td>
<td>Permanently restricted</td>
</tr>
<tr>
<td></td>
<td>Total net assets</td>
</tr>
<tr>
<td></td>
<td>Total liabilities &amp; net assets</td>
</tr>
</tbody>
</table>

**Statement of Activities for NPO**

Similar to income statement
Reports revenues, gains, expenses, & losses
Also reports temporarily restricted assets released from restriction
Categorized activities among unrestricted, temporarily restricted, & permanently
restricted to provide change in net assets for each
Change added to beginning balance to provide ending net assets for each category
Expenses classified by:
Object – nature of item or service obtained
Function – program or activity to which attributed
Character – period or periods benefited from payments

Not-for-Profit Company Statement of Activities For Year Ended December 31, 20X2

<table>
<thead>
<tr>
<th>Revenues &amp; gains</th>
<th>Total</th>
<th>Unrestricted</th>
<th>Temporarily Restricted</th>
<th>Permanently Restricted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Donations</td>
<td>665</td>
<td>265</td>
<td>360</td>
<td>40</td>
</tr>
<tr>
<td>Investment income</td>
<td>10</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total revenues &amp; gains</td>
<td>676</td>
<td>276</td>
<td>360</td>
<td>40</td>
</tr>
<tr>
<td>Net assets released from restriction</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research restrictions</td>
<td>100</td>
<td>(100)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Time restrictions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property restrictions</td>
<td>20</td>
<td>(20)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total net assets released from restriction</td>
<td>120</td>
<td>(120)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenses &amp; losses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>(10)</td>
<td>(10)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program expenses</td>
<td>(190)</td>
<td>(190)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General &amp; administrative</td>
<td>(85)</td>
<td>(85)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries</td>
<td>(70)</td>
<td>(70)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total expenses &amp; losses</td>
<td>(355)</td>
<td>(355)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in net assets</td>
<td>320</td>
<td>40</td>
<td>240</td>
<td>40</td>
</tr>
<tr>
<td>Net assets at December 31, 20X1</td>
<td>70</td>
<td>5</td>
<td>55</td>
<td></td>
</tr>
<tr>
<td>Net assets at December 31, 20X2</td>
<td>500</td>
<td>45</td>
<td>395</td>
<td>40</td>
</tr>
</tbody>
</table>

Statement of Cash Flows for NPO

Similar to statement of cash flows under GAAP
Special treatment for donated assets restricted for long-term purposes
Classified as cash flows from financing activities

Statement of Functional Expenses

Classifies expenses into program services & support services
Program services – expenses directly related to organization’s purpose
Support services – expenses necessary, but not directly related to organization’s
purpose such as fund-raising & administrative expenses
Expenses classified by (similar to statement of activities):
Object
Nature
Character

Contributions Made to and Received by Not-for-Profit Organizations

In general, contributions are income to a not-for-profit organization
Those that are part of the major, ongoing, & central operations are revenues
Those that are not are gains
Unrestricted cash donations:
Cash xxx Donations (unrestricted funds) xxx Permanently restricted
donations:
Cash xxx Donations (permanently restricted funds) xxx Donated services:
Program expense (fair market value) xxx Donations (unrestricted funds) xxx
Cash donations restricted for a specific purposes:
When made:
Cash xxx Donations (temporarily restricted funds) xxx When used:
Temporarily restricted net assets xxx Unrestricted net assets xxx Expense
xxxCash xxx Cash donated for purchase of property:
When made:
Cash xxx Donations (temporarily restricted funds) xxx When used:
Temporarily restricted net assets xxx Unrestricted net assets xxx Expense
xxx

Property xxx Cash xxx Pledges

Promises by outside parties to donate assets
Recognized in period of pledge
Allowance for uncollectible amount established
Some or all may have time restriction – temporarily restricted
Some or all may be unrestricted

Pledges xxx Allowance for uncollectible pledges xxx Donations
(unrestricted funds) xxx Donations (temporarily restricted funds)
xxx Other Donations

Donations of art, antiques, or artifacts not recognized if:
Asset held for research or exhibition
Asset preserved & unaltered
Proceeds from sale of asset to be used to buy additional art, antiques, & artifacts
Donated assets to be held in trust
Not recognized by not-for-profit organization
Disclosed in footnotes to financial statements

Hospital Revenues

Patient service revenue recorded at gross value of services
Billing may be less due to Medicare allowance or employee discount
Difference recorded in allowance account
Statement of activities will report net amount
Services provided for free due to charity not recognized as revenues
Special transactions:
Bad debts recognized as expense on statement of activities, not reduction of
revenues
Miscellaneous revenues from cafeteria, gift shop, parking lot fees, & educational
programs classified as other revenue
Donated supplies reported as operating revenue & expense when used
Donations of essential services and unrestricted donations are nonoperating
revenues
College Tuition Revenues

Students may receive refunds or price breaks

**Refunds** to students reduce tuition revenues

**Price breaks** may result from scholarships or reductions for family members of faculty or staff

Tuition recognized at gross amount

Price break recognized as expense
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